NATIONAL CREDIT UNION ADMINISTRATION

RULES AND REGULATIONS

TRANSMITTAL SHEET **CHANGE 3**

NCUA 8006 (M3500) DATE: June 2005

TO: THE BOARD OF DIRECTORS OF THE FEDERAL CREDIT UNION OR THE FEDERALLY INSURED CREDIT UNION ADDRESSED:

This is Change 3 to the National Credit Union Administration Rules and Regulations (Revised April 2004).

1. **PURPOSE.** To update the April 2004 edition of the National Credit Union Administration Rules and Regulations in the following manner:
   a. **Part 701—Organization and Operation of Federal Credit Unions.**

      § 701.21—Loans to members and lines of credit to members. Revised paragraph (c)(7)(ii)(C).

   b. **Part 708a—Conversion of Insured Credit Unions to Mutual Savings Banks.**

      § 708a.4—Voting procedures. Revised by adding three sentences at the end of paragraph (a) and adding new paragraph (e).

      § 708a.5—Notice to NCUA. Revised by redesignating paragraph (b) as paragraph (b)(1), added a sentence at the end of paragraph (b)(1), and added paragraph (b)(2).

      § 708a.11—Voting guidelines. New section added.

   c. **Part 708b—Mergers of Federally-Insured Credit Unions; Voluntary Termination or Conversion of Insured Shares.**

      Revised the Table of Contents and the entire part.

2. This revision also corrects typing and printing errors.
3. **INSTRUCTIONS:**
   a. Your April 2004 NCUA Rules and Regulations should be updated as follows:

REMOVE OLD PAGES	INSERT NEW PAGES
i–xv	i–xv
701–7 thru 701–8	701–7 thru 701–8
701–11 thru 701–12	701–11 thru 701–12
708a–1 thru 708a–3	708a–1 thru 708a–4
708b–1 thru 708b–8	708b–1 thru 708b–15

4. **PREAMBLES.** Enclosed with Change 3 are Federal Register published preambles. Although not part of the rules, you may find them useful for explanatory purposes.

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(6) *Early payment.* A member may repay a loan, or outstanding balance on a line of credit, prior to maturity in whole or in part on any business day without penalty.

(7) *Loan interest rates—*

(i) *General.* Except when a higher maximum rate is provided for in paragraph (c)(7)(ii) of this section, a Federal credit union may extend credit to its members at rates not to exceed 15 percent per year on the unpaid balance inclusive of all finance charges. Variable rates are permitted on the condition that the effective rate over the term of the loan (or line of credit) does not exceed the maximum permissible rate.

(ii) *Temporary rates.—(A) 21 percent maximum rate.* Effective from December 3, 1980 through May 14, 1987, a Federal credit union may extend credit to its members at rates not to exceed 21 percent per year on the unpaid balance inclusive of all finance charges. Loans and line of credit balances existing on or before May 14, 1987, may continue to bear rates of interest of up to 21 percent per year after May 14, 1987.

(B) *18 percent maximum rate.* Effective May 15, 1987, a Federal credit union may extend credit to its members at rates not to exceed 18 percent per year on the unpaid balance inclusive of all finance charges.

(C) *Expiration.* After September 8, 2006, or as otherwise ordered by the NCUA Board, the maximum rate on federal credit union extensions of credit to members shall revert to 15 percent per year. Higher rates may, however, be charged, in accordance with paragraph (c)(7)(ii)(A) and (B) of this section, on loans and line of credit balance existing on or before September 8, 2006.

(8)(i) Except as otherwise provided herein, no official or employee of a Federal credit union, or immediate family member of an official or employee of a Federal credit union, may receive, directly or indirectly, any commission, fee, or other compensation in connection with any loan made by the credit union.

(ii) For the purposes of this section:

Compensation includes non monetary items, except those of nominal value.

Immediate family member means a spouse or other family member living in the same household.

Loan includes line of credit.

Official means any member of the board of directors or a volunteer committee.

Person means an individual or an organization.

Senior management employee means the credit union's chief executive officer (typically, this individual holds the title of President or Treasurer/Manager), any assistant chief executive officers (e.g., Assistant President, Vice President, or Assistant Treasurer/Manager), and the chief financial officer (Comptroller).

Volunteer official means an official of a credit union who does not receive compensation from the credit union solely for his or her service as an official.

(iii) This section does not prohibit:

(A) Payment, by a Federal credit union, of salary to employees;

(B) Payment, by a Federal credit union, of an incentive or bonus to an employee based on the credit union's overall financial performance;

(C) Payment, by a Federal credit union, of an incentive or bonus to an employee, other than a senior management employee, in connection with a loan or loans made by the credit union, provided that the board of directors of the credit union establishes written policies and internal controls in connection with such incentive or bonus and monitors compliance with such policies and controls at least annually.

(D) Receipt of compensation from a person outside a Federal credit union by a volunteer official or non senior management employee of the credit union, or an immediate family member of a volunteer official or employee of the credit union, for a service or activity performed outside the credit union, provided that no referral has been made by the credit union or the official, employee, or family member.

(d) *Loans and Lines of Credit to Officials—*

(1) *Purpose.* Sections 107(5)(A) (iv) and (v) of the Act require the approval of the board of directors of the Federal credit union in any case where the aggregate of loans to an official and loans on which that official serves as endorser or guarantor exceeds $20,000 plus pledged shares. This paragraph implements the requirement by establishing procedures for determining whether board of directors' approval is required. The section also prohibits preferential treatment of officials.

(2) *Official.* An "official" is any member of the board of directors, credit committee or supervisory committee.

(3) *Initial approval.* All applications for loan or lines of credit on which an official will be

either a direct obligor or an endorser, cosigner or guarantor shall be initially acted upon by either the board of directors, the credit committee or loan officer, as specified in the Federal credit union's bylaws.

(4) *Board of directors' review.* The board of directors shall, in any case, review and approve or deny an application on which an official is a direct obligor, or endorser, cosigner or guarantor if the following computation produces a total in excess of $20,000:

(i) Add:

(A) The amount of the current application.

(B) The outstanding balances of loans including the used portion of an approved line of credit, extended to or endorsed, cosigned or guaranteed by the official.

(C) The total unused portion of approved lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(ii) From the above total subtract:

(A) the amount of shares pledged by the official on loans or lines of credit extended to or endorsed, cosigned or guaranteed by the official.

(B) The amount of shares to be pledged by the official on the loan or line of credit applied for.

(5) *Nonpreferential treatment.* The rates, terms and conditions on any loan or line of credit either made to, or endorsed or guaranteed by

(i) an official

(ii) an immediate family member of an official, or

(iii) any individual having a common ownership, investment or other pecuniary interest in a business enterprise with an official or with an immediate family member of an official shall not be more favorable than the rates, terms and conditions for comparable loans or lines of credit to other credit union members. "Immediate family members" means a spouse or other family member living in the same household.

(e) *Insured, Guaranteed and Advance Commitment Loans.* A loan secured by the insurance or guarantee of, or with an advance commitment to purchase the loan by, the Federal Government, a State government, or any agency of either, may be made for the maturity and under the terms and conditions, including rate of interest, specified in the law, regulations or program under which the insurance, guarantee or commitment is provided.

(f) *20-Year Loans.* Notwithstanding the general 12-year maturity limit on loans to members, a Federal credit union may make loans with maturities of up to 20 years in the case of: (1) a loan to finance the purchase of a mobile home if the mobile home will be used as the member-borrower's residence and the loan is secured by a first lien on the mobile home, (2) a second mortgage loan (or a nonpurchase money first mortgage loan in the case of a residence on which there is no existing first mortgage) if the loan is secured by a residential dwelling which is the residence of the member-borrower, and (3) a loan to finance the repair, alteration, or improvement of a residential dwelling which is the residence of the member-borrower.

(g) *Long-Term Mortgage Loans:*

(1) *Authority.* A Federal credit union may make residential real estate loans to members, with maturities of up to 40 years, or such longer period as may be permitted by the NCUA Board on a case-by-case basis, subject to the conditions of this Section (701.21(g)).

(2) *Statutory limits.* The loan shall be made on a one- to four-family dwelling that is or will be the principal residence of the member-borrower and the loan shall be secured by a perfected first lien in favor of the credit union on such dwelling (or a perfected first security interest in the case of either a residential cooperative or a leasehold or ground rent estate).

(3) *Loan application.* The loan application shall be a completed standard Federal Housing Administration, Veterans Administration, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Federal Home Loan Mortgage Corporation/Federal National Mortgage Association application form. In lieu of use of a standard application the Federal credit union may have a current attorney's opinion on file stating that the forms in use meet the requirements of applicable Federal, state and local laws.

(4) *Security instrument and note.* The security instrument and note shall be executed on the most current version of the FHA, VA, FHLMC, FNMA, or FHLMC/FNMA Uniform Instruments for the jurisdiction in which the property is located. No prepayment penalty shall be allowed, although a Federal credit union may require that any partial prepayments be made on the date monthly installments are due and be in the amount of that part of one or more monthly installments that

§ 701.22 Loan Participation.

(a) For purposes of this section:

(1) "Participation loan" means a loan where one or more eligible organizations participates pursuant to a written agreement with the originating lender.

(2) "Eligible organizations" means a credit union, credit union organization, or financial organization.

(3) "Credit union" means any Federal or state chartered credit union.

(4) *Credit union organization* means any credit union service organization meeting the requirements of part 712 of this chapter. This term does not include trade associations or membership organizations principally composed of credit unions.

(5) *Financial organization* means any federally chartered or federally insured financial institution; and any state or federal government agency and their subdivisions.

(6) "Originating lender" means the participant with which the member contracts.

(b) Subject to the provisions of this section any Federal credit union may participate in making loans with eligible organizations within the limitations of the board of directors' written participation loan policies, PROVIDED:

(1) no Federal credit union shall obtain an interest in a participation loan if the sum of that interest and any (other) indebtedness owing to the Federal credit union by the borrower exceeds 10 per centum of the Federal credit union's unimpaired capital and surplus;

(2) a written master participation agreement shall be properly executed, acted upon by the Federal credit union's board of directors, or if the board has so delegated in its policy, the investment committee or senior management official(s) and retained in the Federal credit union's office. The master agreement shall include provisions for identifying, either through a document which is incorporated by reference into the master agreement, or directly in the master agreement, the participation loan or loans prior to their sale; and

(3) a Federal credit union may sell to or purchase from any participant the servicing of any loan in which it owns a participation interest.

(c) An originating lender which is a Federal credit union shall:

(1) originate loans only to its members;

(2) retain an interest of at least 10 per centum of the face amount of each loan;

(3) retain the original or copies of the loan documents; and

(4) Require the credit committee or loan officer to use the same underwriting standards for participation loans used for loans that are not being sold in a participation agreement unless there is a participation agreement in place prior to the disbursement of the loan. Where a participation agreement is in place prior to disbursement, either the credit union's loan policies or the participation agreement shall address any variance from non-participation loan underwriting standards.

(d) A participant Federal credit union that is not an originating lender shall:

(1) participate only in loans it is empowered to grant, having a participation policy in place which sets forth the loan underwriting standards prior to entering into a participation agreement;

(2) participate in participation loans only if made to its own members or members of another participating credit union;

(3) retain the original or a copy of the written participation loan agreement and a schedule of the loans covered by the agreement; and

(4) obtain the approval of the board of directors or investment committee of the disbursement of proceeds to the originating lender.

§ 701.23 Purchase, Sale, and Pledge of Eligible Obligations.

(a) For purposes of this Section:

(1) "Eligible obligation" means a loan or group of loans;

(2) "Student loan" means a loan granted to finance the borrower's attendance at an institution of higher education or at a vocational school, which is secured by and on which payment of the outstanding principal and interest has been deferred in accordance with the insurance or guarantee of the Federal Government, of a State government, or any agency of either.

(b) Purchase.

(1) A Federal credit union may purchase, in whole or in part, within the limitations of the board of directors' written purchase policies:

(i) Eligible obligations of its members, from any source, if either (A) they are loans it is empowered to grant or (B) they are refinanced with the consent of the borrowers,

within 60 days after they are purchased, so that they are loans it is empowered to grant;

(ii) Eligible obligations of a liquidating credit union's individual members, from the liquidating credit union;

(iii) Student loans, from any source, if the purchaser is granting student loans on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary market; and

(iv) Real estate-secured loans, from any source, if the purchaser is granting real estate secured loans pursuant to Section 701.21 on an ongoing basis and if the purchase will facilitate the purchasing credit union's packaging of a pool of such loans to be sold or pledged on the secondary mortgage market. A pool must include a substantial portion of the credit union's members' loans and must be sold promptly.

(2) A Federal credit union may make purchases in accordance with this paragraph (b), provided:

(i) the board of directors or investment committee approves the purchase;

(ii) a written agreement and a schedule of the eligible obligations covered by the agreement are retained in the purchaser's office; and for purchases under paragraph (b)(1)(ii) of this section, any advance written approval required by § 741.8 of this chapter is obtained before consummation of such purchase.

(3) The aggregate of the unpaid balance of eligible obligations purchased under paragraph (b) of this section cannot exceed 5% of the unimpaired capital and surplus of the purchaser. The following can be excluded in calculating this 5% limitation:

(i) Student loans purchased in accordance with paragraph (b)(1)(iii) of this section;

(ii) Real estate loans purchased in accordance with paragraph (b)(1)(iv) of this section;

(iii) Eligible obligations purchased in accordance with paragraph (b)(1)(i) of this section that are refinanced by the purchaser so that it is a loan it is empowered to grant; and

(iv) An indirect lending or indirect leasing arrangement that is classified as a loan and not the purchase of an eligible obligation because the federal credit union makes the final underwriting decision and the sales or lease contract is assigned to the federal credit union very soon after it is signed by the member and the dealer or leasing company.

(c) Sale.

(1) A Federal credit union may sell, in whole or in part, to any source, eligible obligations of its members, eligible obligations purchased in accordance with subsection (b)(1)(ii), student loans purchased in accordance with subsection (b)(1)(iii), and real estate loans purchased in accordance with subsection (b)(1)(iv), within the limitations of the board of directors' written sale policies, provided:

(i) The board of directors or investment committee approves the sale; and

(ii) A written agreement and a schedule of the eligible obligations covered by the agreement are retained in the seller's office.

(d) Pledge.

(1) A Federal credit union may pledge, in whole or in part, to any source, eligible obligations of its members, eligible obligations purchased in accordance with subsection (b)(1)(ii), student loans purchased in accordance with subsection (b)(1)(iii), and real estate loans purchased in accordance with subsection (b)(1)(iv), within the limitations of the board of directors' written pledge policies, provided:

(i) The board of directors or investment committee approves the pledge;

(ii) Copies of the original loan documents are retained; and

(iii) A written agreement covering the pledging arrangement is retained in the office of the credit union that pledges the eligible obligations.

(2) The pledge agreement shall identify the eligible obligations covered by the agreement.

(e) Servicing.

A Federal credit union may agree to service any eligible obligation it purchases or sells in whole or in part.

(f) 10 Percent Limitation.

The total indebtedness owing to any Federal credit union by any person, inclusive of retained and reacquired interests, shall not exceed 10 percent of its unimpaired capital and surplus.

§ 701.24 Refund of Interest.

(a) The board of directors of a Federal credit union may authorize an interest refund to members who paid interest to the credit union during any dividend period and who are members of record at the close of business on the last day of such dividend period. Interest refunds may be made for a dividend period only if dividends on

Part 708a

Conversion of Insured Credit Unions to Mutual Savings Banks

§ 708a.1 Definitions.

As used in this part:

(a) *Credit union* has the same meaning as insured credit union in section 101 of the Federal Credit Union Act.

(b) *Mutual savings bank* and *savings association* have the same meaning as in section 3 of the Federal Deposit Insurance Act.

(c) *Federal banking agencies* have the same meaning as in section 3 of the Federal Deposit Insurance Act.

(d) *Senior management official* means a chief executive officer, an assistant chief executive officer, a chief financial officer, and any other senior executive officer as defined by the appropriate federal banking agency pursuant to section 32(f) of the Federal Deposit Insurance Act, 12 U.S.C. 1831i(f).

§ 708a.2 Authority to convert.

An insured credit union, with the approval of its members, may convert to a mutual savings bank or a savings association that is in mutual form without the prior approval of the NCUA, subject to applicable law governing mutual savings banks and savings associations and the other requirements of this part.

§ 708a.3 Board of directors and membership approval.

(a) The board of directors must approve a proposal to convert by majority vote and set a date for a vote on the proposal by the members of the credit union.

(b) The membership must approve the proposal to convert by the affirmative vote of a majority of those members who vote on such proposal.

§ 708a.4 Voting procedures.

(a) A member may vote on the proposal to convert in person at a special meeting held on the date set for the vote or by written ballot filed by the member. The vote on the conversion proposal must be by secret ballot and conducted by an independent entity. The independent entity must be a company with experience in conducting corporate elections. No official or senior manager of the credit union, or the immediate family members of any official or senior manager, may have any ownership interest in, or be employed by, the entity.

(b) A credit union that proposes to convert must provide written notice of its intent to convert to each member who is eligible to vote on the conversion. The notice to members must be submitted 90 calendar days, 60 calendar days, and 30 calendar days before the date of the membership vote on the conversion and a ballot must be submitted not less than 30 calendar days before the date of the vote.

(c) The notice to members must adequately describe the purpose and subject matter of the vote to be taken at the special meeting or by submission of the written ballot. The notice must clearly inform the member that the member may vote at the special meeting or by submitting the written ballot. The notice must state the date, time, and place of the meeting.

(d)(1) An adequate description of the purpose and subject matter of the member vote on conversion, as required by paragraph (c) of this section, must include:

(i) A disclosure that the conversion from a credit union to a mutual savings bank could lead to members losing their ownership interests in the credit union if the mutual savings bank subsequently converts to a stock institution and the members do not become stockholders;

(ii) A disclosure of how the conversion from a credit union to a mutual savings bank will affect members' voting rights; and

(iii) A disclosure of any conversion related economic benefit a director or senior management official may receive including receipt of or an increase in compensation and an explanation of any foreseeable stock related benefits associated with a subsequent conversion to a stock institution. The explanation of stock related benefits must include a comparison of the

opportunities to acquire stock that are available to officials and employees, with those opportunities available to the general membership.

(d)(2) In connection with the disclosures required by paragraphs (d)(1)(i) through (iii) of this section, the converting credit union must include an affirmative statement, that at the time of conversion to a mutual savings bank, the credit union does or does not intend to:

(i) Convert to a stock institution;

(ii) Provide any compensation to previously uncompensated directors or increase compensation or other conversion related benefits, including stock related benefits, to directors or senior management officials; and

(iii) Base member voting rights on account balances.

(e) A converting credit union must include the following disclosures with each written communication it sends to its members regarding the conversion. The disclosures must be offset from the other text by use of a border and at least one font size larger than any other text (exclusive of headings) used in the communication. Certain portions of the disclosures must be capitalized and bolded. A converting credit union may modify the disclosure with the prior consent of the Regional Director and, in the case of a state credit union, the appropriate state regulatory agency. The unmodified form of disclosure reads as follows:

The National Credit Union Administration, the federal government agency that supervises credit unions, requires [insert name of credit union] to provide the following disclosures.

1. **OWNERSHIP AND CONTROL.** In a credit union, every member has an equal vote in the election of directors and other matters concerning ownership and control. In a mutual savings bank, **ACCOUNT HOLDERS WITH LARGER BALANCES USUALLY HAVE MORE VOTES AND, THUS, GREATER CONTROL.**
2. **EXPENSES AND THEIR EFFECT ON RATES AND SERVICES.** Most credit union directors and committee members serve on a volunteer basis. Directors of a mutual savings bank are compensated. Credit unions are exempt from federal tax and most state taxes. Mutual savings banks pay taxes, including federal income tax. If [insert name of credit union] converts to a mutual savings bank, these **ADDITIONAL EXPENSES MAY CONTRIBUTE TO LOWER SAVINGS RATES, HIGHER LOAN RATES, OR ADDITIONAL FEES FOR SERVICES.**
3. **SUBSEQUENT CONVERSION TO STOCK INSTITUTION.** Conversion to a mutual savings bank is often the first step in a two-step process to convert to a stock-issuing bank or holding company. In a typical conversion to the stock form of ownership, the **EXECUTIVES OF THE INSTITUTION PROFIT BY OBTAINING STOCK FAR IN EXCESS OF THAT AVAILABLE TO THE INSTITUTION'S MEMBERS.**
4. **COSTS OF CONVERSION.** The costs of converting a credit union to a mutual savings bank are paid from the credit union's current and accumulated earnings. Because accumulated earnings are capital and represent members' ownership interests in a credit union, the conversion costs reduce members' ownership interests. As of [insert date], [insert name of credit union] estimates **THE CONVERSION WILL COST [INSERT DOLLAR AMOUNT] IN TOTAL.** That total amount is further broken down as follows: [itemize the costs of all expenses related to the conversion including printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, conducting the vote, and any other expenses incurred].

§ 708a.5 Notice to NCUA.

(a) The credit union must provide the Regional Director for the region where the credit union is located with notice of its intent to convert during the 90 calendar day period preceding the date of the membership vote on the conversion.

(b)(1) The credit union must give notice to the Regional Director by providing a letter describing the material features of the conversion or a copy of the filing the credit union has made with another federal or state regulatory agency in which the credit union seeks that agency's approval of the conversion. The credit union must include with the notice to the Regional Director a copy of the notice the credit union provides to members under § 708a.4, as well as, the ballot form and all written materials the credit union has distributed or intends to distribute to the members. The term "written materials" includes written documentation or information of any sort, including electronic communications posted on a Web site.

(b)(2) A federally-insured State chartered credit union must include in its notice to NCUA a statement as to whether the State law under which it is chartered permits it to convert to a mutual savings bank and include a legal citation to the State law providing this authority. A federally-insured State chartered credit union will remain subject to any State law requirements for conversion that are more stringent than those this chapter imposes, including any internal governance requirements, such as the requisite membership vote for conversion and the determination of a member's eligibility to vote. If a federally-insured State chartered credit union relies for its authority to convert to a mutual savings bank on a State law parity provision, meaning a provision in State law permitting a State chartered credit union to operate with the same or similar authority as a federal credit union, it must include in its notice

a statement that its State regulatory authority agrees that it may rely on the State law parity provision as authority to convert. If a federally-insured state chartered credit union relies on a State law parity provision for authority to convert, it must indicate its State regulatory authority's position as to whether Federal law and regulations or State law will control internal governance issues in the conversion such as the requisite membership vote for conversion and the determination of a member's eligibility to vote.

(c) If it chooses, the credit union may provide the Regional Director notice of its intent to convert prior to the 90 calendar day period preceding the date of the membership vote on the conversion. In this case, the Regional Director will make a preliminary determination regarding the methods and procedures applicable to the membership vote. The Regional Director will notify the credit union within 30 calendar days of receipt of the credit union's notice of intent to convert if the Regional Director disapproves of the proposed methods and procedures applicable to the membership vote. The credit union's prior submission of the notice of intent does not relieve the credit union of its obligation to certify the results of the membership vote required by § 708a.6 or eliminate the right of the Regional Director to disapprove the actual methods and procedures applicable to the membership vote if the credit union fails to conduct the membership vote in a fair and legal manner.

§ 708a.6 Certification of vote on conversion proposal.

The board of directors of the converting credit union must certify the results of the membership vote to the Regional Director within 10 calendar days after the vote is taken. The board of directors must also certify at this time that the notice, ballot and other written materials provided to members were identical to those submitted pursuant to § 708a.5 or provide copies of any new or revised materials and an explanation of the reasons for the changes.

§ 708a.7 NCUA oversight of methods and procedures of membership vote.

(a) The Regional Director will issue a determination that the methods and procedures applicable to the membership vote are approved or disapproved within 10 calendar days of receipt from the credit union of the certification of the result of the membership vote required under § 708a.6.

(b) If the Regional Director disapproves of the methods by which the membership vote was taken or the procedures applicable to the membership vote, the Regional Director may direct that a new vote be taken.

(c) The Regional Director's review of the methods by which the membership vote was taken and the procedures applicable to the membership vote includes determining that the notice to members is accurate and not misleading, that all notices required by this section were timely, and that the membership vote was conducted in a fair and legal manner.

§ 708a.8 Other regulatory oversight of methods and procedures of membership vote.

The federal or state regulatory agency that will have jurisdiction over the financial institution after conversion must verify the membership vote and may direct that a new vote be taken, if it disapproves of the methods by which the membership vote was taken or the procedures applicable to the membership vote.

§ 708a.9 Completion of conversion.

(a) Upon receipt of approvals under § 708a.7 and § 708a.8 of this part, the credit union may complete the conversion transaction.

(b) Upon notification by the board of directors of the mutual savings bank or mutual savings association that the conversion transaction has been completed, the NCUA will cancel the insurance certificate of the credit union and, if applicable, the charter of the federal credit union.

§ 708a.10 Limit on compensation of officials.

No director or senior management official of an insured credit union may receive any economic benefit in connection with the conversion of the credit union other than compensation and other benefits paid to directors or senior management officials of the converted institution in the ordinary course of business.

§ 708a.11 1Voting guidelines.

(a) A converting credit union must conduct its member vote on conversion in a fair and legal manner. These guidelines are not an exhaustive checklist that guarantees a fair and legal vote but are suggestions that provide a framework to help a credit union fulfill its regulatory obligations.

(b) While NCUA's conversion rule applies to all conversions of federally insured credit unions, federally-insured State chartered credit unions (FISCUs) are also subject to State law on conversions. NCUA's position is that a State legislature or State supervisory authority may impose conversion requirements more stringent or restrictive than NCUA's. States that permit this kind of conversion could have substantive and procedural requirements that vary from Federal law. For example, there could be different voting standards for approving a vote. While NCUA's rule requires a simple majority of those who vote to approve a conversion, some States have higher voting standards requiring two-thirds or more of those who vote. A FISCU should be careful to understand both Federal and State law to navigate the conversion process and conduct a proper vote.

(c)(1) Determining who is eligible to cast a ballot is fundamental to any vote. No conversion vote can be fair and legal if some members are improperly excluded. A converting credit union should be cautious to identify all eligible members and make certain they are included on its voting list. NCUA recommends that a converting credit union establish internal procedures to manage this task.

(2) A converting credit union should be careful to make certain its member list is accurate and complete. For example, when a credit union converts from paper record keeping to computer record keeping, some members' names may not transfer unless the credit union is careful in this regard. This same problem can arise when a credit union converts from one computer system to another where the software is not completely compatible.

(3) Problems with keeping track of who is eligible to vote can also arise when a credit union converts from a federal charter to a State charter or vice versa. NCUA is aware of an instance where a federal credit union used membership materials that allowed two or more individuals to open a joint account and also allowed each to become a member. The federal credit union later converted to a State chartered credit union that, like most other State chartered credit unions in its State, used membership materials that allowed two or more individuals to open a joint account but only allowed the first person listed on the account to become a member. The other individuals did not become members as a result of their joint account. To become members, those individuals were required to open another account where they were the first or only person listed on the account. Over time, some individuals who became members of the federal credit union as the second person listed on a joint account were treated like those individuals who were listed as the second person on a joint account opened directly with the State chartered credit union. Specifically, both of those groups were treated as non-members not entitled to vote. This example makes the point that a credit union must be diligent in maintaining a reliable membership list.

(d) NCUA's conversion rule requires a converting credit union to permit members to vote by written mail ballot or in person at a special meeting held for the purpose of voting on the conversion. Although most members may choose to vote by mail, a significant number may choose to vote in person. As a result, a converting credit union should be careful to conduct its special meeting in a manner conducive to accommodating all members that wish to attend. That includes selecting a meeting location that can accommodate the anticipated number of attendees and is conveniently located. The meeting should also be held on a day and time suitable to most members' schedules. A credit union should conduct its meeting in accordance with applicable federal and State law, its bylaws, Robert's Rules of Order or other appropriate parliamentary procedures, and determine before the meeting the nature and scope of any discussion to be permitted.

Part 708b

Mergers of Federally-Insured Credit Unions; Voluntary Termination or Conversion of Insured Status

§ 708b.1 Scope.

(a) Subpart A of this part prescribes the procedures for merging one or more credit unions with a continuing credit union where at least one of the credit unions is federally-insured.

(b) Subpart B of this part prescribes the procedures and notice requirements for termination of federal insurance or conversion of federal insurance to nonfederal insurance, including termination or conversion resulting from a merger.

(c) Subpart C prescribes required forms for use in conversion of federal insurance to nonfederal insurance.

(d) Nothing in this part restricts or otherwise impairs the authority of the NCUA to approve a merger pursuant to section 205(h) of the Act.

(e) This part does not address procedures or requirements that may be applicable under state law for a state credit union.

§ 708b.2 Definitions.

(a) *Continuing credit union* means the credit union that will continue in operation after the merger.

(b) *Convert, conversion,* and *converting,* when used in connection with insurance, refer to the act of canceling federal insurance and simultaneously obtaining insurance from another insurance carrier. They mean that after cancellation of federal insurance the credit union will be nonfederally-insured.

(c) *Federally-insured* means insured by the National Credit Union Administration (NCUA) through the National Credit Union Share Insurance Fund (NCUSIF).

(d) *Independent entity* means a company with experience in conducting corporate elections. No official or senior manager of the credit union, or the immediate family members of any official or senior manager, may have any ownership interest in, or be employed by, the entity.

(e) *Insurance* and *insured* refer to primary share or deposit insurance. These terms do not include excess share or deposit insurance as referred to in part 740 of this chapter.

(f) *Merging credit union* means the credit union that will cease to exist as an operating credit union at the time of the merger.

(g) *Nonfederally-insured* means insured by a private or cooperative insurance fund or guaranty corporation organized or chartered under state or territorial law.

(h) *Share insurance communication* means any written communication, excluding the forms in Subpart C of this Part, that is made by or on behalf of a federally-insured credit union that is intended to be read by two or more credit union members and that mentions share insurance conversion or termination. The term:

(1) Includes communications delivered or made available before, during, and after the credit union's board of directors decides to seek conversion or termination.

(2) Includes, but is not limited to, communications delivered or made available by mail, e-mail, and internet website posting.

(3) Does not include communications intended to be read only by the credit union's own employees or officials.

(i) *State credit union* means any credit union organized and operated according to the laws of any state, the several territories and possessions of the United States, or the Commonwealth of Puerto Rico. Accordingly, *state authority* means the appropriate state or territorial regulatory or supervisory authority for any such credit union.

(j) *Terminate, termination,* and *terminating,* when used in reference to insurance, refer to the act of canceling federal insurance and mean that the credit union will become uninsured.

(k) *Uninsured* means there is no share or deposit insurance available on the credit union accounts.

Subpart A—Mergers

§ 708b.101 Mergers generally.

(a) In any case where a merger will result in the termination of federal insurance or conversion to nonfederal insurance, the merging credit union must comply with the provisions of subparts B and C of this part in addition to this subpart A.

(b) A federally-insured credit union must have the prior written approval of the NCUA before merging with any other credit union.

(c) Where the continuing credit union is a federal credit union, it must be in compliance with the chartering policies of the NCUA.

(d) Where the continuing or merging credit union is a state credit union, the merger must be permitted by state law or authorized by the state authority.

(e) Where both the merging and continuing credit unions are federally-insured and the two credit unions have overlapping fields of membership, the continuing credit union must, within three months after completion of the merger, either:

(1) Notify all members of the continuing credit union of the potential loss of insurance coverage if they had overlapping membership,

(2) Notify all individuals and entities that were actually members of both credit unions of the potential loss of insurance coverage, or

(3) Determine which members of both credit unions may actually have uninsured funds six months after the merger and notify those members of the potential loss of insurance coverage.

§ 708b.102 Special provisions for federal insurance.

(a) Where the continuing credit union is federally-insured, the NCUSIF will assess a deposit and a prorated insurance premium (unless waived in whole or in part for all insured credit unions during that year) on the additional share accounts insured as a result of the merger of a nonfederally-insured or uninsured credit union with a federally-insured credit union.

(b) Where the continuing credit union is nonfederally-insured or uninsured but desires to be federally-insured as of the date of the merger, it must submit an application to the appropriate Regional Director when the merging credit union requests approval of the merger proposal. If the Regional Director approves the merger, the NCUSIF will assess a deposit and a prorated insurance premium (unless waived in whole or in part for all insured credit unions during that year) on any additional share accounts insured as a result of the merger.

(c) Where the continuing credit union is nonfederally-insured or uninsured and does not make application for insurance, but the merging credit union is federally-insured, the continuing credit union is entitled to a refund of the merging credit union's NCUSIF deposit and to a refund of the unused portion of the NCUSIF share insurance premium (if any). If the continuing credit union is uninsured, the NCUSIF will make the refund only after expiration of the one-year period of continued insurance coverage noted in paragraph (e) of this section.

(d) Where the continuing credit union is nonfederally-insured, NCUSIF insurance of the member accounts of a merging federally-insured credit union ceases as of the effective date of the merger.

(e) Where the continuing credit union is uninsured, NCUSIF insurance of the member accounts of the merging federally-insured credit union will continue for a period of one year, subject to the restrictions in section 206(d)(1) of the Act.

§ 708b.103 Preparation of merger plan.

(a) Upon the approval of a proposition for merger by the boards of directors of the credit unions, the two credit unions must prepare a plan for the proposed merger that includes:

(1) Current financial statements for both credit unions;

(2) Current delinquent loan summaries and analyses of the adequacy of the Allowance for Loan and Lease Losses account;

(3) Consolidated financial statements, including an assessment of the generally accepted accounting principles (GAAP) net worth of each credit union before the merger and the GAAP net worth of the continuing credit union after the merger;

(4) Analyses of share values;

(5) Explanation of any proposed share adjustments;

(6) Explanation of any provisions for reserves, undivided earnings or dividends;

(7) Provisions with respect to notification and payment of creditors;

(8) Explanation of any changes relative to insurance such as life savings and loan protection insurance and insurance of member accounts;

(9) Provisions for determining that all assets and liabilities of the continuing credit union will conform with the requirements of the Act (where the continuing credit union is a federal credit union); and

(10) Proposed charter amendments (where the continuing credit union is a federal credit union). These amendments, if any, will usually

pertain to the name of the credit union and the definition of its field of membership.

(b) [Reserved]

§ 708b.104 Submission of merger proposal to the NCUA.

(a) Upon approval of the merger plan by the boards of directors of the credit unions, the credit unions must submit the following information to the Regional Director:

(1) The merger plan, as described in this part;

(2) Resolutions of the boards of directors;

(3) Proposed Merger Agreement;

(4) Proposed Notice of Special Meeting of the Members (for merging federal credit unions);

(5) Copy of the form of Ballot to be sent to the members (for merging federal credit unions);

(6) Evidence that the state's supervisory authority approves the merger proposal (for states that require such agreement before NCUA approval);

(7) Application and Agreement for Insurance of Member Accounts (for continuing state credit unions desiring to become federally-insured);

(8) If the merging credit union has $50 million or more in assets on its latest call report, a statement about whether the two credit unions intend to make a Hart-Scott-Rodino Act premerger notification filing with the Federal Trade Commission and, if not, an explanation why not; and

(9) For mergers where the continuing credit union is not federally-insured and will not apply for federal insurance:

(i) A written statement from the continuing credit union that it "is aware of the requirements of 12 U.S.C. 1831t(b), including all notification and acknowledgment requirements"; and

(ii) Proof that the accounts of the credit union will be accepted for coverage by the nonfederal insurer (if the credit union will have nonfederal insurance).

(b) [Reserved]

§ 708b.105 Approval of merger proposal by the NCUA.

(a) In any case where the continuing credit union is federally-insured and the merging credit union is nonfederally-insured or uninsured, the NCUA will determine the potential risk to the NCUSIF.

(b) If the NCUA finds that the merger proposal complies with the provisions of this Part and does not present an undue risk to the NCUSIF, it may approve the proposal subject to any other specific requirements as it may prescribe to fulfill the intended purposes of the proposed merger. For mergers of federal credit unions into federally-insured credit unions, if the NCUA determines that the merging credit union is in danger of insolvency and that the proposed merger would reduce the risk or avoid a threatened loss to the NCUSIF, the NCUA may permit the merger to become effective without an affirmative vote of the membership of the merging credit union otherwise required by § 708b.106 of this part.

(c) NCUA may approve any proposed charter amendments for a continuing federal credit union contingent upon the completion of the merger. All charter amendments must be consistent with NCUA chartering policy.

§ 708b.106 Approval of the merger proposal by members.

(a) When the merging credit union is a federal credit union, the members must:

(1) Have the right to vote on the merger proposal in person at the annual meeting, if within 60 days after NCUA approval, or at a special meeting to be called within 60 days of NCUA approval, or by mail ballot, received no later than the date and time announced for the annual meeting or the special meeting called for that purpose.

(2) Be given advance notice of the meeting in accordance with the provisions of Article IV, Meetings of Members, Federal Credit Union Bylaws. The notice must:

(i) Specify the purpose of the meeting and the time and place;

(ii) Contain a summary of the merger plan, including, but not necessarily limited to, current financial statements for each credit union, a consolidated financial statement for the continuing credit union, analyses of share values, explanation of any proposed share adjustments, explanation of any changes relative to insurance such as life savings and loan protection insurance and insurance of member accounts;

(iii) State reasons for the proposed merger;

(iv) Provide name and location, including branches, of the continuing credit union;

(v) Inform the members that they have the right to vote on the merger proposal in person at the meeting or by written ballot to be received no later than the date and time announced for the annual meeting or the special meeting called for that purpose; and

(vi) Be accompanied by a Ballot for Merger Proposal.

(b) Approval of a proposal to merge a federal credit union into a federally-insured credit union requires the affirmative vote of a majority of the members of the merging credit union who vote on the proposal. If the continuing credit union is uninsured or nonfederally-insured, the voting requirements of subpart B apply. If the continuing credit union is nonfederally-insured, the merging credit union must use the form notice and ballot in subpart C of this part unless the Regional Director approves the use of different forms.

§ 708b.107 Certificate of vote on merger proposal.

The board of directors of the merging federal credit union must certify the results of the membership vote to the Regional Director within 10 days after the vote is taken. The certification must include the total number of members of record of the credit union, the number who voted on the merger, the number who voted in favor, and the number who voted against. If the continuing credit union is nonfederally-insured, the merging credit union must use the certification form in subpart C of this part unless the Regional Director approves the use of a different form.

§ 708b.108 Completion of merger.

(a) Upon approval of the merger proposal by the NCUA and by the state supervisory authority (where the continuing or merging credit union is a state credit union) and by the members of each credit union where required, the credit unions may complete the merger.

(b) Upon completion of the merger, the board of directors of the continuing credit union must certify the completion of the merger to the Regional Director within 30 days after the effective date of the merger.

(c) Upon the NCUA's receipt of certification that the merger has been completed, the NCUA will cancel the charter of the merging federal credit union (if applicable) and the insurance certificate of any merging federally-insured credit union.

Subpart B—Voluntary Termination or Conversion of Insured Status

§ 708b.201 Termination of insurance.

(a) A state credit union may terminate federal insurance, if permitted by state law, either on its own or by merging into an uninsured credit union.

(b) A federal credit union may terminate federal insurance only by merging into, or converting its charter to, an uninsured state credit union.

(c) A majority of the credit union's members must approve a termination of insurance by affirmative vote. The credit union must use an independent entity to collect and tally the votes and certify the results for all terminations, including terminations that involve a merger or charter conversion. The vote must be taken by secret ballot, meaning that no credit union employee or official can determine how a particular member voted.

(d) Termination of federal insurance requires the NCUA's prior written approval. A credit union must notify the NCUA and request approval of the termination through the Regional Director in writing at least 90 days before the proposed termination date and within one year after obtaining the membership vote. The notice to the NCUA must include:

(1) A written statement from the credit union that it "is aware of the requirements of 12 U.S.C. 1831t(b), including all notification and acknowledgment requirements;" and

(2) A certification of the member vote that must include the total number of members of record of the credit union, the number who voted in favor of the termination, and the number who voted against.

(e) The NCUA will approve or disapprove the termination in writing within 90 days after being notified by the credit union.

§ 708b.202 Notice to members of proposal to terminate insurance.

(a) When the board of directors of a federally-insured credit union adopts a resolution proposing to terminate federal insurance, including termination due to a merger or conversion of charter, it must provide its members with written notice of the proposal to terminate and of the date set for the membership vote. The first written communication following the resolution that is made by or on behalf of the credit union and that informs the members that the credit union will seek termination is the notice of the proposal to terminate. This notice must:

(1) Inform the members of the requirement for a membership vote and the date for the vote;

(2) Explain that the insurance provided by the NCUA is federal insurance and is backed by the full faith and credit of the United States government; and

(3) Include a conspicuous statement that if the termination or merger is approved, and the credit union, or the continuing credit union in the case of a merger, subsequently fails, the federal government does not guarantee the member will get his or her money back.

(b) The credit union must deliver the notice in person to each member, or mail it to each member at the address for the member as it appears on the records of the credit union, not more than 30 nor less than 7 days before the date of the vote. The membership must be given the opportunity to vote by mail ballot. The credit union may provide the notice of the proposal and the ballot to members at the same time.

(c) If the membership and the NCUA approve the proposition for termination of insurance, the credit union must give the members prompt and reasonable notice of termination.

§ 708b.203 Conversion of insurance.

(a) A federally-insured state credit union may convert to nonfederal insurance, if permitted by state law, either on its own or by merging into a nonfederally-insured credit union.

(b) A federal credit union may convert to nonfederal insurance only by merging into, or converting its charter to, a nonfederally-insured state credit union.

(c) Conversion to nonfederal insurance requires the prior written approval of the NCUA. After the credit union board of directors resolves to seek a conversion, the credit union must notify the Regional Director promptly, in writing, of the desired conversion and request NCUA approval of the conversion. The notification must be in the form specified in subpart C of this part, unless the Regional Director approves a different form. The credit union must provide this notification and request for approval to the Regional Director at least 14 days before the credit union notifies its members and seeks their vote and at least 90 days before the proposed conversion date. NCUA will approve or disapprove the conversion as described in paragraph (g) of this section.

(d) Approval of a conversion of federal to nonfederal insurance requires the affirmative vote of a majority of the credit union's members who vote on the proposition, provided at least 20 percent of the total membership participates in the voting. The credit union must use an independent entity to collect and tally the votes and certify the results for all share insurance conversions, including share insurance conversions that involve a merger or charter conversion. The vote must be taken by secret ballot, meaning that no credit union employee or official can determine how a particular member voted.

(e) For all conversions, the notice to the NCUA must include:

(1) A written statement from the credit union that it "it is aware of the requirements of 12 U.S.C. 1831t(b), including all notification and acknowledgment requirements;" and

(2) Proof that the nonfederal insurer is authorized to issue share insurance in the state where the credit union is located and that the insurer will insure the credit union.

(f) The board of directors of the credit union and the independent entity that conducts the membership vote must certify the results of the membership vote to the NCUA within 10 days after the deadline for receipt of votes. The certification must include the total number of members of record of the credit union, the number who voted on the conversion, the number who voted in favor of the conversion, and the number who voted against. The certification must be in the form specified in subpart C of this part.

(g) Generally, the NCUA will approve or disapprove the conversion in writing within 14 days after receiving the certification of the vote.

(h) For conversions by merger, the merging credit unions must follow the procedures specified in

subparts A and B of this part and use the forms specified in subpart C of this part. In the event the procedures of Subpart A and B conflict, the credit union must follow subpart B.

§ 708b.204 Notice to members of proposal to convert insurance.

(a) When the board of directors of a federally-insured credit union adopts a resolution proposing to convert from federal to nonfederal insurance, including an insurance conversion associated with a merger or conversion of charter, it must provide its members with written notice of the proposal to convert insurance and of the date set for the membership vote. The first written communication following this resolution that is made by or on behalf of the credit union and that informs the members that the credit union will seek conversion of insurance is the notice of the proposal to convert. This notice must:

(1) Inform the members of the requirement for a membership vote and the date for the vote;

(2) Explain that the insurance provided by the NCUA is federal insurance and is backed by the full faith and credit of the United States government, while the insurance provided by the nonfederal insurer is not guaranteed by the federal or any state government;

(3) Include a conspicuous statement that if the conversion or merger is approved, and the credit union, or the continuing credit union in the case of a merger, subsequently fails, the federal government does not guarantee the member will get his or her money back; and

(4) Be in the form set forth in subpart C of this part, unless the Regional Director approves a different form.

(b) The credit union must deliver the notice in person to each member or mail it to each member at the address for the member as it appears on the records of the credit union, not more than 30 nor less than 7 days before the date for the vote. The credit union must give the membership the opportunity to vote by mail ballot. The form of the ballot must be as set forth in subpart C of this part, unless the Regional Director approves the use of a different form. The notice of the proposal and the ballot may be provided to the members at the same time.

(c) If the membership and the NCUA approve the proposition for conversion of insurance, the credit union will give prompt and reasonable notice to the membership. The credit union must deliver the notice at least 30 days before the effective date of the conversion. The notice must identify the effective date of the conversion, and the first page must also include a conspicuous statement (*i.e.*, in bold and no smaller than any other font size used in the notice) that:

(1) The conversion will result in the loss of federal share insurance, and

(2) The credit union will, at any time before the effective date of conversion, permit all members who have share certificates or other term accounts to close the federally-insured portion of those accounts without an early withdrawal penalty.

§ 708b.205 Modifications to notice and ballot.

(a) Converting credit unions will use the form notice and ballot as provided in subpart C of this part unless the Regional Director approves the use of a different form.

(b) A converting credit union will provide the Regional Director with a copy of the notice and ballot, including any reasons for conversion and estimated costs of conversion, on or before the date the notice and ballot are mailed to the members.

(c) Federally-insured state credit unions may include additional language in the notice and ballot regarding state requirements for mergers, where appropriate.

§ 708b.206 Share insurance communications to members.

(a) Every share insurance communication must comply with § 740.2 of this chapter, which, in part, prohibits federally-insured credit unions from making any representation that is inaccurate or deceptive in any particular.

(b) Every share insurance communication about share insurance conversion must contain the following conspicuous statement: "IF YOU ARE A MEMBER OF THIS CREDIT UNION, YOUR ACCOUNTS ARE CURRENTLY INSURED BY THE NATIONAL CREDIT UNION ADMINISTRATION, A FEDERAL AGENCY. THIS FEDERAL INSURANCE IS BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES GOVERNMENT. IF THE CREDIT UNION CONVERTS TO PRIVATE INSURANCE AND THE CREDIT UNION FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT

YOU WILL GET YOUR MONEY BACK." The statement must:

(1) Appear on the first page of the communication where conversion is discussed and, if the communication is on an internet website posting, the credit union must make reasonable efforts to make it visible without scrolling; and

(2) Must be in capital letters, bolded, offset from the other text by use of a border, and at least one font size larger than any other text (exclusive of headings) used in the communication.

(c) Every share insurance communication about share insurance termination must contain the following conspicuous statement: "IF YOU ARE A MEMBER OF THIS CREDIT UNION, YOUR ACCOUNTS ARE CURRENTLY INSURED BY THE NATIONAL CREDIT UNION ADMINISTRATION, A FEDERAL AGENCY. THIS FEDERAL INSURANCE IS BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES GOVERNMENT. IF THE CREDIT UNION TERMINATES ITS FEDERAL INSURANCE AND THE CREDIT UNION FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT YOU WILL GET YOUR MONEY BACK." The statement must:

(1) Appear on the first page of the communication where termination is discussed and, if the communication is on an internet website posting, the credit union must make reasonable efforts to make it visible without scrolling; and

(2) Must be in capital letters, bolded, offset from the other text by use of a border, and at least one font size larger than any other text (exclusive of headings) used in the communication.

(d) A converting credit union must provide the Regional Director with a copy of any share insurance communication that the credit union will make during the voting period. The Regional Director must receive the copy at or before the time the credit union makes it available to members. The converting credit union must inform the Regional Director when the communication is to be made, to which members it will be directed, and how it will be disseminated. For purposes of this section, the voting period begins on the date of the board of director's resolution to seek conversion or termination and ends on the date the member voting closes.

(e) The Regional Director may take appropriate action, including disapproving a conversion, if he or she determines that a converting credit union, by inclusion or omission of information in a share insurance communication, materially mislead or misinformed its membership. For example, the Regional Director will treat any share insurance communication that compares the relative strength, safety, or claims paying ability of a private insurer with that of the National Credit Union Share Insurance Fund as materially misleading if the comparison fails to mention that the federal insurance provided by the NCUA is backed by the full faith and credit of the United States government.

Subpart C—Forms

§ 708b.301 Conversion of insurance (State Chartered Credit Union).

Unless the Regional Director approves the use of different forms, a state chartered credit union must use the forms in this section in connection with a conversion to nonfederal insurance.

(a) Form letter notifying NCUA of intent to convert:

(insert name), NCUA Regional Director

(insert address of NCUA Regional Director)

Re: Notice of Intent to Convert to Private Share Insurance

Dear Director (insert name):

In accordance with federal law at Title 12, United States Code Section 1785(b)(1)(D), I request the National Credit Union Administration approve the conversion of (insert name of credit union) from federal share insurance to private primary share insurance with (insert name of private insurance company).

On (insert date), the board of directors of (insert name of credit union) resolved to pursue the conversion from federal insurance to private insurance. A copy of the resolution is enclosed.

On (insert date), the credit union plans to solicit the vote of our members on the conversion. The credit union will employ (insert name, address, and telephone number of independent entity) to conduct the member vote. The credit union will use the form notice and ballot required by NCUA regulations, and will certify the results to NCUA as required by NCUA regulations.

Aside from the notice and ballot, the credit union (does)(does not) intend to provide its members with additional written information about the conversion. I understand that NCUA regulations forbid any communications to members, including

communications about NCUA insurance or private insurance, that are inaccurate or deceptive.

(Insert name of State) allows credit unions to obtain primary share insurance from (insert name of private insurance company). I have enclosed a copy of a letter from (insert name and title of state regulator) establishing that (insert name of private insurer) has the authority to provide (insert name of credit union) with primary share insurance.

I have enclosed a copy of a letter from (insert name of private insurer) indicating it has accepted (insert name of credit union) for primary share insurance and will insure the credit union immediately upon the date that it loses its federal share insurance.

I am aware of the requirements of 12 U.S.C. 1831t(b), including all notification and acknowledgment requirements.

The point of contact for conversion matters is (insert name and title of credit union employee), who can be reached at (insert telephone number).

Sincerely,

(signature)

Chief Executive Officer.

Enclosures

(b) Form notice to members of intent to convert and special meeting of members:

Notice of Proposal to Convert to Nonfederally-Insured Status and Special Meeting of Members

(Insert Name of Converting Credit Union)

On (insert date), the board of directors of your credit union approved a proposition to convert from federal share (deposit) insurance to private insurance. You are encouraged to attend a special meeting of our credit union at (insert address) on (insert time and date) to address this proposition.

Purpose of Meeting

The meeting has two purposes:

1. To consider and act upon a proposal to convert your account insurance from federal insurance to private insurance.

2. To approve the action of the Board of Directors in authorizing the officers of the credit union to carry out the proposed conversion.

Insurance Conversion

Currently, your accounts have share insurance provided by the National Credit Union Administration, an agency of the federal government. The basic federal coverage is up to $100,000, but accounts may be structured in different ways, such as joint accounts, payable-on-death accounts, or IRA accounts, to achieve federal coverage of much more than $100,000. If the conversion is approved, your federal insurance will terminate on the effective date of the conversion. Instead, your accounts in the credit union will be insured up to $(insert dollar amount) by (insert name of insurer), a corporation chartered by the State of (insert name of State). The federal insurance provided by the National Credit Union Administration is backed by the full faith and credit of the United States government. The private insurance you will receive from (insert name of insurer), however, is not guaranteed by the federal or any state or local government.

IF THIS CONVERSION IS APPROVED, AND THE (insert name of credit union) FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE YOU WILL GET YOUR MONEY BACK.

Also, because this conversion, if approved, would result in the loss of federal share insurance, the credit union will, at any time between the approval of the conversion and the effective date of conversion and upon request by the member, permit all members who have share certificates or other term accounts to close the federally-insured portion of those accounts without an early withdrawal penalty. (This is an optional sentence. It may be deleted without the approval of the Regional Director. The members must be informed about this right, however, as described in 12 CFR 708b.204(c).)

The board of directors has concluded that the proposed conversion is desirable for the following reasons: (insert reasons). (This is an optional paragraph. It may be deleted without the prior approval of the Regional Director.)

The proposed conversion will result in the following one-time cost associated with the conversion: (List the total estimated dollar amount, including (1) the cost of conducting the vote, (2) the

cost of changing the credit union's name and insurance logo, and (3) attorney and consultant fees.)

The conversion must have the approval of a majority of members who vote on the proposal, provided at least 20 percent of the total membership participates in the voting.

Enclosed with this Notice of Special Meeting is a ballot. If you cannot attend the meeting, please complete the ballot and return it to (insert name and address of independent entity conducting the vote) by no later than (insert time and date). To be counted, your ballot must reach us by that date and time.

By order of the board of directors.

(signature of Board Presiding Officer)

(insert title and date)

(c) Form ballot:

Ballot for Conversion to Nonfederally-Insured Status

Insert Name of Converting Credit Union)

Name of Member: (insert name)

Account Number: (insert account number)

The credit union must receive this ballot by (insert date and time for vote). Please mail or bring it to: (Insert name of independent entity and address)

I understand if the conversion of the (insert name of credit union) is approved, the National Credit Union Administration share (deposit) insurance I now have, up to $100,000, or possibly more if I use different accounts structures, will terminate upon the effective date of the conversion. Instead, my shares in the (insert name of credit union) will be insured up to $(insert dollar amount) by (insert name of insurer), a corporation chartered by the State of (insert name of state). The federal insurance provided by the National Credit Union Administration is backed by the full faith and credit of the United States Government. The private insurance provided by (insert name of insurer) is not.

I FURTHER UNDERSTAND THAT IF THIS CONVERSION IS APPROVED AND THE (insert name of credit union) FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT I WILL GET MY MONEY BACK.

I vote on the proposal as follows (check one box):

[ ] Approve the conversion to private insurance and authorize the Board of Directors to take all necessary action to accomplish the conversion.

[ ] Do not approve the conversion to private insurance.

Signed: _____

(Insert printed member's name)

Date: _____

(d) Form certification of member vote to NCUA:

Certification of Vote on Conversion to Nonfederally-Insured Status

We, the undersigned officers of the (insert name of converting credit union), certify the completion of the following actions:

1. At a meeting on (insert date), the Board of Directors adopted a resolution to seek the conversion of our primary share insurance coverage from NCUA to (insert name of private insurer).

2. Not more than 30 nor less than 7 days before the date of the vote, copies of the notice of special meeting and the ballot, as approved by the National Credit Union Administration, were mailed to our members.

3. The credit union arranged for the conduct of a special meeting of our members at the time and place announced in the Notice to consider and act upon the proposed conversion.

4. At the special meeting, the credit union arranged for an explanation of the conversion to the members present at the special meeting.

5. The (insert name), an entity independent of the credit union, conducted the membership vote at the special meeting. The members voted as follows:

(insert) Number of total members

(insert) Number of members present at the special meeting

(insert) Number of members present who voted in favor of the conversion

(insert) Number of members present who voted against the conversion

(insert) Number of additional written ballots in favor of the conversion

(insert) Number of additional written ballots opposed to the conversion

(insert "20% or more") OR (insert "Less than 20%") of the total membership voted. Of those who voted, a majority voted (inset "in favor of") OR ("against") conversion.

The action of the members at the special meeting was recorded in the minutes.

This certification signed the (insert date).

(signature of Board Presiding Officer)
(insert typed name and title)
(signature of Board Secretary)
(insert typed name and title)

I (insert name), an officer of the (insert name of independent entity that conducted the vote), hereby certify that the information recorded in paragraph 5 above is accurate.

This certification signed the (insert date):

(signature of officer of independent entity)
(typed name, title, and phone number)

§ 708b.302 Conversion of Insurance (Federal Credit Union).

Unless the Regional Director approves the use of different forms, a federal credit union must use the following forms in this section in connection with a conversion to a nonfederally-insured state charter.

(a) Form letter notifying NCUA of intent to convert:

(insert name), NCUA Regional Director
(insert address of NCUA Regional Director)
Re: Notice of Intent to Convert to State Charter and to Private Share Insurance

Dear Director (insert name):

In accordance with federal law at Title 12, United States Code Section 1785(b)(1)(D), I request the National Credit Union Administration approve the conversion of (insert name of federal credit union) to a state charter in (insert name of state) and from federal share insurance to private primary share insurance with (insert name of private insurance company).

On (insert date), the board of directors of (insert name of credit union) resolved to pursue the charter conversion and the conversion from federal insurance to private insurance. A copy of the resolution is enclosed.

On (insert date), the credit union plans to solicit the vote of our members on the conversion. The credit union will employ (insert name, address, and telephone number of independent entity) to conduct the vote. The credit union will use the form notice and ballot required by NCUA regulations, and will certify the results to NCUA as required by NCUA regulations.

Aside from the notice and ballot, the credit union (does)(does not) intend to provide our members with additional written information about the conversion. I understand that NCUA regulations forbid any communications to members, including communications about NCUA insurance or private insurance, that are inaccurate or deceptive.

I have enclosed a copy of a letter from (insert name and title of state regulator) indicating approval of our conversion to a state charter.

(Insert name of State) allows credit unions to obtain primary share insurance from (insert name of private insurance company). I have enclosed a copy of a letter from (insert name and title of state regulator) establishing that (insert name of private insurer) has the authority to provide (insert name of credit union), after conversion to a state charter, with primary share insurance.

I have enclosed a copy of a letter from (insert name of private insurer) indicating it has accepted (insert name of credit union) for primary share insurance and will insure the credit union immediately upon the date that it loses its federal share insurance.

I am aware of the requirements of 12 U.S.C. 1831t(b), including all notification and acknowledgment requirements.

Enclosed you will also find other information required by NCUA's Chartering and Field of Membership Manual, Chapter 4, § III.C.

The point of contact for conversion matters is (insert name and title of credit union employee), who can be reached at (insert telephone number).

Sincerely,

(signature),
Chief Executive Officer.

Enclosures

(b) Form notice to members of intent to convert and special meeting of members:

Notice of Proposal to Convert to a State Charter and to Nonfederally-Insured Status and Special Meeting of Members

(Insert Name of Converting Credit Union)

On (insert date), the board of directors of your credit union approved a proposition to convert from federal share (deposit) insurance to private insurance and to convert from a federal credit union to a state-chartered credit union. You are encouraged to attend a special meeting of our credit union at (insert address) on (insert time and date) to address this proposition.

Purpose of Meeting

The meeting has two purposes:

1. To consider and act upon a proposal to convert your credit union from a federal charter to a state charter and your account insurance from federal insurance to private insurance.

2. To approve the action of the Board of Directors in authorizing the officers of the credit union to carry out the proposed conversion.

Insurance Conversion

Currently, your accounts have share insurance provided by the National Credit Union Administration, an agency of the federal government. The basic federal coverage is up to $100,000, but accounts may be structured in different ways, such as joint accounts, payable-on-death accounts, or IRA accounts, to achieve federal coverage of much more than $100,000. If the conversion is approved, your federal insurance will terminate on the effective date of the conversion. Instead, your accounts in the credit union will be insured up to $(insert dollar amount) by (insert name of insurer), a corporation chartered by the State of (insert name of State). The federal insurance provided by the National Credit Union Administration is backed by the full faith and credit of the United States government. The private insurance you will receive from (insert name of insurer), however, is not guaranteed by the federal or any state or local government.

IF THIS CONVERSION IS APPROVED, AND THE (insert name of credit union) FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE YOU WILL GET YOUR MONEY BACK.

Also, because this conversion, if approved, would result in the loss of federal share insurance, the credit union will, at any time between the approval of the conversion and the effective date of conversion and upon request of the member, permit all members who have share certificates or other term accounts to close the federally-insured portion of those accounts without an early withdrawal penalty. (This is an optional sentence. It may be deleted without the approval of the Regional Director. The members must be informed about this right, however, as described in 12 CFR 708b.204(c).)

The board of directors has concluded that the proposed conversion is desirable for the following reasons: (Insert reasons) (This is an optional paragraph. It may be deleted without the approval of the Regional Director.).

The proposed conversion will result in the following one-time cost associated with the conversion: (List the total estimated dollar amount, including (1) the cost of conducting the vote, (2) the cost of changing the credit union's name and insurance logo, and (3) attorney and consultant fees.)

The conversion must have the approval of a majority of members who vote on the proposal, provided at least 20 percent of the total membership participates in the voting.

Enclosed with this Notice of Special Meeting is a ballot. If you cannot attend the meeting, please complete the ballot and return it to (insert name and address of independent entity conducting the vote) by no later than (insert time and date). To be counted, your ballot must reach us by that date and time.

By order of the board of directors.

(signature of Board Presiding Officer)

(insert title and date)

(c) Form ballot:

Ballot for Conversion to State Charter and Nonfederally-Insured Status

(Insert Name of Converting Credit Union)

Name of Member: (insert name)

Account Number: (insert account number)

The credit union must receive this ballot by (insert date and time for vote). Please mail or bring it to: (Insert name of independent entity and address)

I understand if the conversion of the (insert name of credit union) is approved, the National Credit Union Administration share (deposit) insurance I now have, up to $100,000, or possibly more if I use different accounts structures, will terminate upon the effective date of the conversion. Instead, my shares in the (insert name of credit union) will be insured up to $(insert dollar amount) by (insert name of insurer), a corporation chartered by the State of (insert name of state). The federal insurance provided by the National Credit Union Administration is backed by the full faith and credit of the United States Government.

The private insurance provided by (insert name of insurer) is not.

I FURTHER UNDERSTAND THAT, IF THIS CONVERSION IS APPROVED AND THE (insert name of credit union) FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT I WILL GET MY MONEY BACK.

I vote on the proposal as follows (check one box):

[ ] Approve the conversion of charter and conversion to private insurance and authorize the Board of Directors to take all necessary action to accomplish the conversion.

[ ] Do not approve the conversion of charter and the conversion to private insurance.

Signed: _____
(Insert printed member's name)

Date: _____

(d) Form certification to NCUA of member vote:

Certification of Vote on Conversion to State Charter and Nonfederally-Insured Status

We, the undersigned officers of the (insert name of converting credit union), certify the completion of the following actions:

1. At a meeting on (insert date), the Board of Directors adopted a resolution to seek the conversion of our credit union to a state charter and the conversion of our primary share insurance coverage from NCUA to (insert name of private insurer).

2. Not more than 30 nor less than 7 days before the date of the vote, copies of the notice of special meeting and ballot, as approved by the National Credit Union Administration, were mailed to our members.

3. The credit union arranged for the conduct of a special meeting of our members at the time and place announced in the Notice to consider and act upon the proposed conversion.

4. At the special meeting, the credit union arranged for an explanation of the conversion to the members present at the special meeting.

5. The (insert name), and entity independent of the credit union, conducted the membership vote at the special meeting. The members voted as follows:

(insert) Number of total members

(insert) Number of members present at the special meeting

(insert) Number of members present who voted in favor of the conversion

(insert) Number of members present who voted against the conversion

(insert) Number of additional written ballots in favor of the conversion

(insert) Number of additional written ballots opposed to the conversion

(insert "20% or more") OR (insert "Less than 20%") of the total membership voted. Of those who voted, a majority voted (inset "in favor of") OR ("against") conversion.

The action of the members at the special meeting was recorded in the minutes.

This certification signed the (insert date).

(signature of Board Presiding Officer)
(insert typed name and title)
(signature of Board Secretary)
(insert typed name and title)

I (insert name), an officer of the (insert name of independent entity that conducted the vote), hereby certify that the information recorded in paragraph 5 above is accurate.

This certification signed the (insert date):

(signature of officer of independent entity)
(typed name, title, and phone number)

§ 708b.303 Conversion of insurance through merger.

Unless the Regional Director approves the use of different forms, a federally-insured credit union that is merging into a nonfederally-insured credit union must use the forms in this section.

(a) Form notice to members of intent to merge and convert and special meeting of members:

Notice of Special Meeting on Proposal to Merge and Convert to Nonfederally-Insured Status

(Insert Name of Merging Credit Union)

On (insert date), the Board of Directors of your credit union approved a proposition to merge with

(insert name of continuing credit union) and to convert from federal share (deposit) insurance to private insurance. You are encouraged to attend a special meeting of our credit union at (insert address) on (insert time and date).

Purpose of Meeting

The meeting has two purposes:

1. To consider and act upon a proposal to merge our credit union with (insert name of continuing credit union), the continuing credit union.

2. To approve the action of the Board of Directors of our credit union in authorizing the officers of the credit union, subject to member approval, to carry out the proposed merger.

If this merger is approved, our credit union will transfer all its assets and liabilities to the continuing credit union. As a member of our credit union, you will become a member of the continuing credit union. On the effective date of the merger, you will receive shares in the continuing credit union for the shares you own now in our credit union.

Insurance Conversion

Currently, your accounts have share insurance provided by the National Credit Union Administration, an agency of the federal government. The basic federal coverage is up to $100,000, but accounts may be structured in different ways, such as joint accounts, payable-on-death accounts, or IRA accounts, to achieve federal coverage of much more than $100,000. If the merger is approved, your federal insurance will terminate on the effective date of the merger. Instead, your accounts in the credit union will be insured up to $(insert dollar amount) by (insert name of insurer), a corporation chartered by the State of (insert name of State). The federal insurance provided by the National Credit Union Administration is backed by the full faith and credit of the United States government. The private insurance you will receive from (insert name of insurer), however, is not guaranteed by the federal or any state or local government.

IF THIS MERGER IS APPROVED AND THE (insert name of continuing credit union) FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE YOU WILL GET YOUR MONEY BACK.

Also, because this merger, if approved, would result in the loss of federal share insurance, the (insert name of merging credit union) will, at any time between the approval of the merger and the effective date of merger and upon request of the member, permit all members who have share certificates or other term accounts to close the federally-insured portion of those accounts without an early withdrawal penalty. (This is an optional sentence. It may be deleted without the approval of the Regional Director. The members must be informed about this right, however, as described in 12 CFR 708b.204(c).)

Other Information Related to the Proposed Merger

The directors of the participating credit unions carefully analyzed the assets and liabilities of the participating credit unions and appraised each credit union's share values. The appraisal of the share values appears on the attached individual and consolidated financial statements of the participating credit unions.

The directors of the participating credit unions have concluded that the proposed merger is desirable for the following reasons: (insert reasons)

The Board of Directors of our credit union believes the merger should include/not include an adjustment in shares for the following reasons: (insert reasons)

The main office of the continuing credit union will be as follows: (insert location)

The branch office(s) of the continuing credit union will be as follows: (insert locations)

The merger must have the approval of a majority of members who vote on the proposal, provided at least 20 percent of the total membership participates in the voting.

Enclosed with this Notice of Special Meeting is a Ballot for Merger Proposal and Conversion to Nonfederally-insured Status. If you cannot attend the meeting, please complete the ballot and return it to (insert name of independent entity conducting vote) at (insert mailing address) by no later than (insert date and time). To be counted, your ballot must reach (insert name of inde-

pendent entity conducting vote) by the date and time announced for the meeting.

By order of the board of directors.

(signature of Board Presiding Officer)
(insert name and title of Board Presiding Officer) (insert date)

(b) Form ballot:

Ballot for Merger Proposal and Conversion to Nonfederally-Insured Status

Name of Member: (insert name)
Account Number: (insert account number)

The credit union must receive this ballot by (insert date and time for vote). Please mail or bring it to: (Insert name of independent entity and address)

I understand if the merger of conversion of the (insert name of merging credit union)into the (insert name of merging credit union is approved, the National Credit Union Administration share (deposit) insurance I now have, up to $100,000, or possibly more if I use different account structures, will terminate upon the effective date of the conversion. Instead, my shares in the (insert name of credit union) will be insured up to $(insert dollar amount) by (insert name of insurer), a corporation chartered by the State of (insert name of state). The federal insurance provided by the National Credit Union Administration is backed by the full faith and credit of the United States Government. The private insurance provided by (insert name of insurer) is not.

I FURTHER UNDERSTAND THAT, IF THIS MERGER IS APPROVED AND THE (insert name of continuing credit union) FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT I WILL GET MY MONEY BACK.

I vote on the proposal as follows (check one box):

[ ] Approve the merger and the conversion to private insurance and authorize the Board of Directors to take all necessary action to accomplish the merger and conversion.

[ ] Do not approve the merger and the conversion to private insurance.

Signed: _____
(Insert printed member's name)

Date: _____

(c) Form certification of vote:

Certification of Vote on Merger Proposal and Conversion to Nonfederally-Insured Status of the (Insert Name of Merging Credit Union)

We, the undersigned officers of the (insert name of merging credit union), certify the completion of the following actions:

1. At a meeting on (insert date), the Board of Directors adopted a resolution approving the merger of our credit union with (insert name of continuing credit union).

2. Not more than 30 nor less than 7 days before the date of the vote, copies of the notice of special meeting and the ballot, as approved by the National Credit Union Administration, and a copy of the merger plan announced in the notice, were mailed to our members.

3. The credit union arranged for the conduct of a special meeting of our members at the time and place announced in the Notice to consider and act upon the proposed merger.

4. At the special meeting, the credit union arranged for an explanation of the merger proposal and any changes in federally-insured status to the members present at the special meeting.

5. The (insert name), and entity independent of the credit union, conducted the membership vote at the special meeting. At least 20 percent of our total membership voted and a majority of voting members favor the merger as follows:

(insert) Number of total members

(insert) Number of members present at the special meeting

(insert) Number of members present who voted in favor of the merger

(insert) Number of members present who voted against the merger

(insert) Number of additional written ballots in favor of the merger

(insert) Number of additional written ballots opposed to the merger

6. The action of the members at the special meeting was recorded in the minutes.

This certification signed the (insert date):

(signature of Board Presiding Officer)
(insert typed name and title)
(signature of Board Secretary)
(insert typed name and title)

I (insert name), an officer of the (insert name of independent entity that conducted the vote), hereby certify that the information recorded in paragraph 5 above is accurate.

This certification signed the (insert date):

(signature of officer of independent entity)
(typed name, title, and phone number)

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708b

Mergers of Federally-Insured Credit Unions; Voluntary Termination or Conversion of Insured Status

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The National Credit Union Administration (NCUA) is issuing final revisions to its rule on credit union mergers, federal share insurance terminations, and conversions from federal share insurance to nonfederal insurance. The final rule establishes disclosure requirements to ensure that members have the opportunity to be fully and properly informed before they vote on whether to convert from federal insurance to nonfederal insurance. The rule provides protections to members who may lose federal insurance because they have large insured accounts at two federally-insured credit unions that are merging or they have term accounts at a federally-insured credit union that is converting to nonfederal insurance. The rule also requires merging credit unions to analyze the premerger requirements imposed on credit unions by the Hart-Scott-Rodino Act and provides other miscellaneous updates to the existing rule governing credit union mergers, terminations, and conversions of share insurance.

DATES: This rule is effective February 23, 2005.

FOR FURTHER INFORMATION CONTACT: Paul Peterson, Staff Attorney, Division of Operations, Office of General Counsel, at the above address or telephone: (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

The Federal Credit Union Act (Act) authorizes the NCUA Board to prescribe rules regarding mergers of federally-insured credit unions and changes in insured status and requires written approval of the Board before one or more federally-insured credit unions merge or before a federally-insured credit union terminates federal insurance or converts to nonfederal insurance. 12 U.S.C. 1752(7), 1766(a), 1785(b), 1785(c), and 1789(a). Part 708b of NCUA's rules addresses the merger of federally-insured credit unions and the voluntary termination or conversion of federally-insured status. 12 CFR part 708b.

The Board has a policy of continually reviewing NCUA regulations to ''update, clarify and simplify existing regulations and eliminate redundant and unnecessary provisions.'' NCUA Interpretive Ruling and Policy Statement (IRPS) 87–2, Developing and Reviewing Government Regulations. As a result of the NCUA's 2003 review, the Board determined that part 708b should be updated and modernized. In July 2004, the Board published its proposed amendments for a 60-day public comment. 69 FR 45279 (July 29, 2004).

NCUA received 88 comment letters on the proposed rule. The comments came from a variety of sources, including state supervisory authorities (SSAs), credit unions (federal and state chartered; federally and privately insured), credit union trade organizations, credit union consultants, a law firm, a private share insurer, and members of Congress. Almost all the commenters commented on the share insurance conversion portion of the proposal. A few of the commenters also commented on the merger portion of the proposal.

The majority of the commenters objected to various portions of the proposed share insurance conversion rule. About ninety percent of the credit unions submitting comments objected to various portions of it. Most of the commenting credit union leagues and trade organizations also object to the rule, while two support it. Six members of Congress wrote in general objection to the rule, while two wrote in general support of the rule. Three SSAs wrote in general objection to the rule, while one wrote in support. A private share insurer, American Mutual Share Insurance Corporation (ASI), objects to the rule.

B. General Comments About the Proposed Rulemaking

Several commenters supported the proposed amendments to the share insurance conversion part of the rule, particularly the changes in disclosures and increased NCUA oversight of share insurance communications. These commenters generally thought the proposal would result in credit union members receiving more accurate information when voting on conversions.

Many commenters complained about the proposed rulemaking as it relates to share insurance conversion. Some of the general themes of the commenters who object to the rule are that: NCUA does not have the legal authority to approve or disapprove conversions to private insurance; NCUA is in a conflict of interest situation and is improperly regulating the private share insurer; NCUA is undermining the dual chartering system because it is regulating in an area that is the province of state regulators; NCUA is confusing its role as insurer and regulator and this rulemaking is proof that the functions should be separated; and NCUA has not provided sufficient information about problems with the current conversion process. These commenters believe no rulemaking is necessary.

The NCUA Board disagrees with many of these comments about the proposed share insurance conversion rulemaking. First, the Act charges the NCUA Board with approving or disapproving conversions of federally-insured credit unions to ''noninsured credit unions,'' and the Act defines a noninsured credit union as any credit union that does not have federal insurance, to include uninsured and privately insured credit unions. 12 U.S.C. 1752(7), 1785(b)(1)(D). Second, this proposed regulation does not regulate private insurance or private insurers. The Act charges NCUA with ensuring that the needs of credit union members are met during share insurance conversions and terminations. 12 U.S.C. 1785(c). This rulemaking is about ensuring that members have accurate information. Third, the rule acknowledges the participation of the SSAs in the conversion process. Since federal law assigns an approval function to NCUA, however, the regulation of conversions is not the sole province of state regulators. Accordingly, the proposed rulemaking does not undermine the dual chartering system. Fourth, federal law places both safety and soundness and consumer protection responsibilities on NCUA. The Board believes these responsibilities are not in conflict and this rulemaking does not evidence a need to separate NCUA's ''insurer'' and ''regulator'' functions.

The Board appreciates the requests of some commenters for more information about the need for this rulemaking, particularly the need for increased disclosures and oversight of communications to members during the share insurance conversion process. Additional information on that aspect appears in Section C of the **SUPPLEMENTARY INFORMATION**. Some commenters had concerns with particular provisions in the proposed rule and the final rule contains several changes in response to these comments. Comments on particular provisions and the associated changes are discussed in Sections D and E of the Supplementary Information.

C. The Need for This Rulemaking

Many commenters said they did not understand why NCUA was proposing to change the disclosures to members of

credit unions converting to private insurance and to expand the scope of communications subject to NCUA review. As the Board indicated in the Supplementary Information to the proposed rule:

The Board is concerned about communications that credit unions may make that are intended to influence the member vote. While a credit union seeking to convert or terminate may make its case for conversion or termination to its members, it may not do so by misleading, inaccurate, or deceptive representations. For example, the Board believes that any discussion of NCUA insurance, or any comparison of nonfederal insurance to NCUA insurance, is inaccurate and deceptive if it fails to mention the most important aspect of NCUA insurance: by law, it is backed by the full faith and credit of the United States government. Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, Section 901, 101 Stat. 657 (1987); *Massachusetts Credit Union Share Insurance Corporation* v. *National Credit Union Administration,* 693 F.Supp. 1225, 1230–31 (D.C.D.C. 1988) (''The Court concludes that it was the clear and unambiguous intention of the Congress to guarantee the resources of * * * depository institutions with the full faith and credit of the United States.''). The Board is also concerned about representations that state or imply that it is difficult or impossible to structure accounts at a federally-insured institution to obtain more than $100,000 of share insurance coverage as these representations are also inaccurate and deceptive.

69 FR 45279, 45280–81 (July 29, 2004). The Board's concerns about inaccurate and misleading share insurance communications are not hypothetical but based on actual communications made by credit unions. Some examples follow.

Example 1: Misleading comparison about the relative financial safety of private insurance and NCUSIF insurance.

In comparing the safety of private insurance to the NCUA Share Insurance Fund (NCUSIF), a credit union stated in a 2004 communication to members:

Financial safety of a share insurance program is measured in terms of equity available to pay a claim. ASI's equity is the strongest of all national insurers. For example, the Federal Deposit Insurance Corporation (FDIC) touts having $1.30 for each $1.00 it insures. The National Credit Union Share Insurance Fund has $1.27 as of year end 2001. ASI's stands at $1.33 * * * the highest of all.

This statement inaccurately indicates the equity ratio of the insurance funds is the main determinant of the relative safety and strength of the private and federal funds. While fund equity is important to a private insurer, which may have no real alternative source of funding to pay claims, the comparison to the NCUSIF fails to take into consideration factors such as the relative size of the funds, the relative risk diversification, available lines of credit, and, most importantly, the fact that the NCUSIF is backed by the full faith and credit of the United States government. To avoid misleading credit union members, any comparison of the safety, strength, or relative claims paying ability of the NCUA and a private fund must state that accounts insured by NCUA are guaranteed by the United States government and accounts insured by the private fund are not guaranteed by the federal government or by any state or local government. This fact was not mentioned anywhere in the credit union's communication promoting conversion. NCUA's view is that comment about the relative strength of private insurance funds with the NCUSIF is *per se* misleading if it fails to mention that the NCUSIF is backed by the full faith and credit of the United States Government.

Example 2: Misleading statement that a credit union's assets are safer with private insurance.

A credit union made the following statement to its members in a 2004 newsletter article explaining why its members were better off with private insurance than NCUSIF insurance:

If the worst happened, [name of credit union]'s assets are safer with ASI deposit insurance. In the unlikely event that several credit unions failed at once, [the credit union] could potentially face greater financial risk with federally backed deposit insurance than with ASI private deposit insurance. With federal insurance, all of [the credit union]'s reserves (currently $58 million) could be used to bail out other credit unions. With ASI private deposit insurance, only 3% of [the credit union]'s total assets (currently $19.96 million) could be used.

(Emphasis in original). This statement is inaccurate and misleading for the following reasons.

First, the credit union's statement that ''[w]ith ASI private deposit insurance, only 3% of [name of credit union]'s total assets (currently $19.96 million) could be used'' is wrong. In reality, the credit union's potential liability is unlimited. ASI's Standard Primary Share Insurance Contract (SPSIC) says that ASI requires an insured credit union to make capital contributions sufficient to maintain the normal operating level of its Guarantee Fund. The SPSIC also says that insured credit unions do not have to make contributions or assessments that exceed 3% of their total assets ''unless otherwise ordered by the Superintendent of the Division of Financial Institutions in the Insurer's state of domicile.'' Further, ASI is domiciled in Ohio and Ohio law states that whenever the Ohio SSA or superintendent of insurance considers it necessary for the maintenance of ASI's normal operating level—a minimum of one percent—the superintendent ''shall order'' ASI to levy and collect additions to the capital contributions. Ohio Rev. Code Ann. § § 1761.10(A)(1), § 1761.10(B)(1) (2004). So, contrary to the statement in the credit union's newsletter, if ASI suffered significant financial losses, there is no 3% limit on the credit union's assets subject to additional levies.

The history of depository institutions that lack federal insurance provides another reason why a credit union's assets are not safer with private share insurance. In the event of numerous failures of privately insured credit unions, the depositors at other privately insured institutions, even healthy ones, may lose confidence in their institutions as they hear and read about the failures. This loss of confidence increases the withdrawal rate at all privately-insured institutions, regardless of financial health. The run on these institutions may cause a liquidity crisis and forces them to sell assets. Illiquid assets then must be sold, often at less than fair market value, causing significant losses to these institutions and perhaps even insolvency. By comparison, the threat of heavy withdrawals is not significant for an NCUSIF-insured institution, because the backing of the full faith and credit of the United States maintains the confidence of the depositors in the safety of their funds and limits the potential for disastrous runs.

This potential for a run on privately-insured institutions is not just theoretical. In 1985, and again in 1991, private deposit and share insurers in Ohio, Maryland, and Rhode Island collapsed. One Ohio Congressman said the following about the 1985 collapse:

The experience in Ohio and Maryland demonstrated that once an institution suffers heavy losses a chain reaction can begin in which doubt among consumers about the ability of the [private] insurance fund to cover the losses can quickly erode the public's confidence in the safety of their money at other similarly insured institutions and soon a panic begins * * *. If all the depository institutions in Ohio and Maryland had

been federally insured, the outcome would have been different and consumers would not have gone through the trauma of thinking they were wiped out * * *.

131 Cong. Rec. E3979 (daily ed. Sept. 11, 1985) (Statement of Rep. Oakar). Also, a report on the Rhode Island collapse stated that:

Public confidence is one of the most important assets of a deposit insurer. When the situation at Heritage [a depository institution in financial trouble that was insured by the Rhode Island Share and Deposit Indemnity Corporation (RISDIC), a private share insurer] came to light, the public undoubtedly became more skeptical of RISDIC and its constituent members. Withdrawals from some of the larger institutions further weakened their reserves. Recognizing the potential effects of a RISDIC collapse, state officials encouraged RISDIC institutions to apply for federal insurance in order to protect their depositors.

Vartan Gregorian, *Carved in Sand,* A Report on the Collapse of the Rhode Island Share and Deposit Indemnity Corporation (Brown University, 1991), p. 105.

Example 3: Misleading statement about maximizing federal share insurance coverage.

In comparing the amount of coverage available from NCUA and ASI, a credit union made the following statement in a 2004 communication to its members:

As an ASI-insured member, coverage on your deposit accounts would increase from $100,000 per member, as currently insured by the National Credit Union Share Insurance Fund (NCUSIF), to $250,000 per account under ASI. Instead of members struggling to structure their savings with us to maximize their deposit insurance coverage, as under Federal insurance, members will be able to have multiple deposit relationships with [name of credit union], knowing that each account is separately insured up to $250,000!

Credit union members do not have to struggle to structure their savings to achieve more than $100,000 of share insurance coverage at a federally-insured credit union. Many account forms can be created easily to increase insurance coverage, including payable-on-death accounts, joint accounts, and IRA accounts.

Example 4: Statements Made By the Private Insurer.

Credit unions work closely with ASI, the lone provider of private, primary share insurance in the United States, when converting insurance and ASI mistakenly questions the federal guarantee that backs the NCUSIF. ASI's comment letter to NCUA in this rulemaking states:

ASI objects to the requirement that the Notice state: 'THIS FEDERAL INSURANCE IS BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES GOVERNMENT.' There is no statutory guarantee for the Fund * * *. The only reference to extending the 'full faith and credit' to credit union share insurance is set forth in the 100th Congress' 'findings,' which are not law or in any way binding beyond the 100th Congress.

The Competitive Equality Banking Act of 1987 (CEBA), referred to in ASI's mention of the 100th Congress above, states that it ''is the sense of Congress that it should reaffirm that deposits up to the statutorily prescribed amount in federally insured depository institutions are backed by the full faith and credit of the United States.'' Pub. L. No. 100–86 (1987), § 901. As stated previously, and contrary to ASI's assertion in its comment letter, a federal court found that this statement is binding. *Massachusetts Share Insurance Corporation* v. *National Credit Union Administration,* 693 F.Supp. 1225, 1231 (D.C.D.C. 1988) (''The Court concludes that it was the clear and unambiguous intention of the Congress to guarantee the resources of federal depository institutions with the full faith and credit of the United States.'').

As indicated by Congress' use of the word ''reaffirmation'' in the CEBA, NCUA's insurance program had the backing of the full faith and credit of the United States government even before that 1987 law. The U.S. Department of Justice (DOJ) has stated that ''a guaranty by a Government agency contracted pursuant to a congressional grant of authority for constitutional purposes is an obligation fully binding on the United States despite the absence of statutory language expressly pledging its 'faith' or 'credit' to the redemption of the guaranty and despite the possibility that a future appropriation might be necessary to carry out such redemption.'' *Debt Obligations of the National Credit Union Administration,* 6 Op. Off. Legal Counsel 262, 264 (1982). The chief legal officer of the Legislative Branch has similarly stated that the ''[s]tatutory language expressly pledging the credit of the United States is not required to create obligations of the United States * * *. Rather, when Congress authorizes a federal agency or officer to incur obligations, those obligations are supported by the full faith and credit of the United States, unless the authorizing statute specifically provides otherwise.'' Comptroller General of the United States, B–277814 (October 20, 1997). NCUA is a federal agency; it has a statutory obligation to pay share insurance claims; and, as a matter of law, NCUA's share insurance obligation is backed by the full faith and credit of the United States government.

After reviewing both the communications made by converting credit unions and the views stated by the private insurer about federal insurance, the Board believes it has ample reason to engage in this rulemaking to inform both credit unions and their members.

Sections D and E below discuss the specific amendments proposed by the Board, the comments received on those amendments, and the treatment of those proposed amendments in the final rule.

D. Proposed Amendments—Mergers

1. Amendment Related to the Hart-Scott-Rodino Act

The Hart-Scott-Rodino Act (HSR Act), 15 U.S.C. 18a, requires that parties to certain mergers or acquisitions, including credit unions, notify the Federal Trade Commission (FTC) before consummating the merger or acquisition. Only mergers involving relatively large credit unions require HSR filings because merging entities below a certain asset size are exempt. Generally, credit unions need not file if (1) the merging credit union has less than $50 million in assets or (2) the merging credit union has from $50 million up to $200 million in assets and the continuing credit union is below a certain asset size established by the FTC. The amendment requires a merging credit union that has more than $50 million in assets as reported on its last call report to inform NCUA in its merger proposal if the credit union plans to make an HSR filing and, if not, why not.

One commenter supported the amendment, stating it would provide merging credit unions with an additional safeguard to ensure they comply with HSR. One commenter thought demonstration of HSR compliance was an unnecessary burden. This commenter stated that Congress is considering eliminating this requirement and, if it does, the agency would then have to eliminate the regulation. Another commenter questioned the practical application of the HSR filing requirements to credit union mergers or acquisitions since such mergers lack ''significant anticompetitive effect on the marketplace.''

The final rule retains the requirement that merging credit unions with $50 million or more in assets inform NCUA of whether or not they plan to make an HSR filing. Merging credit unions must comply with the HSR Act, and unless and until the law changes, NCUA wants to make sure credit unions are aware of and comply with their HSR responsibilities.

2. Amendment Requiring Notice to Members of Potential Loss of Insurance in a Merger

The Board proposed an amendment to require notice to members regarding the potential reduction of account insurance coverage resulting from the merger of two federally-insured credit unions. Two credit unions that are proposing to merge may have overlapping fields of membership, and there may be individuals who belong to both credit unions. If these individuals have the same types of accounts at both credit unions in an aggregate amount exceeding $100,000, they run the risk of losing some insurance coverage on their accounts as a result of the merger. To ensure these members are aware of the possible loss of coverage, the amendment requires the continuing credit union either: (1) Notify all members of the continuing credit union of the potential loss of insurance coverage from overlapping fields of membership; (2) notify all individuals who are members of both credit unions of the potential loss of insurance coverage; or (3) determine which members of both credit unions may actually have uninsured funds six months after the merger and notify those members of the potential loss of insurance coverage.

One commenter supported the proposed notification requirements because of the possible loss of share insurance due to merger and the flexibility given to credit unions in the various ways they could carry out the notification. Another commenter opposed the proposed rule, stating that the notice could have the unintended consequence of creating anxiety and uncertainty with regard to the condition of the credit unions involved and the perception that members' deposits are unsafe.

The final rule retains this provision as proposed. The Board believes merging credit unions can craft the notice to the members in a way that mitigates any possible anxiety or uncertainty about the health of the merging credit unions.

3. Amendment Requiring Merging Credit Unions to Analyze Net Worth Before and After Merger

The amendment requires merging credit unions to analyze the net worth of the two credit unions before merger, as calculated under generally accepted accounting principles (GAAP), and compare those figures with the estimated net worth of the continuing credit union after merger. The one commenter who addressed this proposal supports it because the board of directors and management of the two credit unions must consider this information before recommending a merger. The final rule retains this provision as proposed.

E. Proposed Amendments—Credit Union Share Insurance Conversions and Terminations

1. Amendment Requiring Modified and Additional Share Insurance Disclosures

Section 151 of the Federal Deposit Corporation Improvement Act of 1991 (FDICIA) added Section 43 to the Federal Deposit Insurance Act (FDIA). Pub. L. 102–242 (1991), Section 151(a); Pub. L. No. 102–550 (1992), Section 1603(b)(2); and 12 U.S.C. 1831t(b). Section 43 of the FDIA requires, among other things, that depository institutions, including credit unions, that do not have federal account insurance make conspicuous disclosure of that fact and its potential ramifications to their current and potential account holders in various media. For example, nonfederally-insured institutions must make conspicuous disclosures that ''the institution is not federally-insured, and that if the institution fails, the Federal Government does not guarantee that depositors will get back their money.'' 12 U.S.C. 1831t(b)(1).

In a recent report, the U.S. General Accounting Office (GAO) found that ''many privately insured credit unions have not always complied with the disclosure requirements in Section 43 that are designed to notify consumers that the deposits in these institutions are not federally-insured.'' ''Federal Deposit Insurance Act: FTC Best Among Candidates to Enforce Consumer Protection Provisions'', GAO–03–0971, p. 20 (August, 2003). As the title of the report suggests, GAO concluded that FTC is the most appropriate federal agency to enforce the provisions of Section 43 with respect to nonfederally-insured credit unions. NCUA has a responsibility, however, to ensure that members of a federally-insured credit union are fully informed in connection with a vote to terminate federal insurance or convert from federal to nonfederal insurance and believes it is important that management understands its disclosure requirements post-conversion. *See* 12 U.S.C. 1785(c)(5). The proposed amendments provided for revising the requirements in connection with the membership vote of credit unions seeking to terminate or convert from federal insurance, requiring the credit unions to acknowledge Section 43 and certify they will comply with its requirements following termination or conversion.

Federally-insured credit unions intending to terminate federal insurance or convert to nonfederal insurance must first obtain approval from their members, and part 708b currently requires credit unions to use certain language to disclose to members, as part of the notification of member vote, the effects of insurance termination or conversion. The current disclosure language required by part 708b is similar to that required by Section 43 following the loss of federal insurance. The proposal provided for modifying the part 708b disclosures to make them more consistent with the Section 43 disclosures and updating the form notices, ballots, and certifications in subpart C of part 708b.

The current rule does not contain any disclosure requirements for communications other than the disclosures contained in the form notice and ballot. The proposed rule provided for including the following disclosure language in a conspicuous fashion in all share insurance communications: ''IF YOU ARE A MEMBER OF THIS CREDIT UNION, YOUR ACCOUNTS ARE CURRENTLY INSURED BY THE NATIONAL CREDIT UNION ADMINISTRATION, A FEDERAL AGENCY. THIS INSURANCE IS BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES GOVERNMENT. IF THE CREDIT UNION (CONVERTS TO PRIVATE INSURANCE) (TERMINATES ITS FEDERAL INSURANCE), AND THE CREDIT UNION FAILS, THE FEDERAL GOVERNMENT DOES NOT GUARANTEE THAT YOU WILL GET YOUR MONEY BACK.''

This proposed disclosure language tracks the disclosures required of nonfederally-insured credit unions by Section 43(b) of the FDIA after conversion. 12 U.S.C. 1831t(b). The proposal required this language be included in all share insurance communications whether or not the communication requires prior NCUA approval and whether or not the credit union has made a formal decision to seek conversion or termination. The

proposed rule also tracked Section 43(b) by requiring that the disclosure language be conspicuous. To ensure that the disclosure catches the attention of the member, the proposal required the disclosure be on the first page of the communication where conversion is discussed, in capital letters, bolded, offset from the other text by use of a border, and at least one font size larger than any other text (exclusive of headings) used in the communication.

The final rule adopts the amendments as proposed, with some modifications in response to public comments received. A summary of the public comments and the Board's response follows.

Many credit unions submitted a virtually identical comment about the proposed disclosures. These commenters believe that, when Congress enacted FDICIA in 1991, ''it concluded'' that the disclosures only apply to privately insured credit unions. These commenters also contend Congress selected the FTC to regulate and enforce such consumer disclosures, not the NCUA, and believe that the proposed rule is ''contrary to the instructions'' of Congress.

The Board agrees that it is the FTC that has responsibility for enforcement of FDICIA and that FDICIA's provisions only apply to credit unions after they convert to private insurance. As NCUA is charged with the approval of conversions, its focus is on what occurs before the FTC assumes responsibility for enforcement of FDICIA. The NCUA Board believes it makes eminent sense for members to receive the same disclosures about the nature of private insurance before conversion, when considering whether to vote for or against conversion, that they will be entitled to receive afterward. Further, the Board believes credit unions may not be aware of their FDICIA responsibilities if they choose to convert given the fact that, as noted in the previously mentioned GAO report, many privately insured credit unions are not complying with FDICIA. The costs and effects of FDICIA compliance are also factors credit unions should consider in making the conversion decision. Accordingly, the final rule requires a converting credit union to inform NCUA that ''it is aware of the requirements of 12 U.S.C. 1831t(b)'' in lieu of the proposal that would have required the credit union to inform NCUA that ''it will fully comply with the requirements of 12 U.S.C. 1831t(b).''

Several commenters support the proposed amendments to the disclosure provisions. One of these commenters states it will help credit union members make well-informed decisions when voting on insurance conversion and termination issues. This commenter asks that NCUA also consider requiring converting credit unions to notify their members of a vote on share insurance conversion or termination a minimum number of times and that the notice be sent by at least two different means: for example, via a statement stuffer and a direct letter, along with some other general notification efforts, such as a newspaper article or a posting on the credit union's website. According to the commenter, this would help ensure that credit unions make a good faith effort to encourage members to vote on insurance issues and would help avoid the situation in which a handful of members decide for all. Another commenter that supports the proposed disclosures said NCUA should also require disclosure of certain information about the prospective private insurer, such as the shares insured and the amount of resources available to indemnify those shares. This commenter felt this information and an evaluation of the prospective insurer by an independent analyst could be useful for credit union members to make an informed decision.

Additional notification requirements are beyond the scope of the proposed rule, and the Board does not see a need at this time for additional notification requirements. The Act requires that at least 20% of the members vote, which mitigates the possibility that a handful of members will make the decision. While the Board believes a converting credit union should undertake to provide its members as much relevant and accurate information about the private insurer as possible, it believes the amount of information provided is a decision best left to credit union management. The Board is only requiring that the information provided to members beyond the required disclosures not be inaccurate or misleading.

A few commenters believe the capitalization of ''DO NOT approve'' on the proposed member ballot indicates an NCUA bias towards disapproval. This was not the Board's intent and the final rule removes the capitalization.

One commenter believes the proposed rule's requirement that the disclosure, when posted on the web, must be visible without scrolling is impossible to meet, given that a credit union does not have control over a viewer's monitor size or other computer access device, including hand-held devices. The Board appreciates this concern. The language of the final rule has been modified to require converting credit unions to make reasonable efforts to make the disclosure visible without scrolling. If most of the disclosure is visible on a standard-size computer screen without scrolling the Board will consider the placement of the disclosure as reasonable.

A few commenters believe that the current disclosures are already excessive because members are ''bombarded'' with this information before, during, and after conversion. The Board disagrees. The Board believes that, currently, in many conversions the first communications members receive about conversion do not contain the important information in the proposed disclosures, that the members do not focus on the fine print in the notice and ballot when they receive those documents, and that many members are not made aware of this information until after the vote and the conversion are complete.

ASI commented that the FDICIA-like disclosure ''in the context of a conversion vote would give the false impression that privately insured credit unions are more likely to fail than federally-insured credit unions.'' The Board does not agree that the FDICIA-like language gives this impression. Credit unions can fail, regardless of whether they are privately or federally-insured. What the FDICIA language states is that, if a privately insured credit union fails, the federal government does not guarantee that the member will get his or her money back.

One commenter described the proposed disclosures as ''draconian,'' and said that ''[I]f we were to truly disclose, then we would have to add that the reserves of the entire credit union industry would have to be depleted before the Federal Government would step in to make a depositor whole up to the limits of the insurance coverage.'' The Board disagrees. There is nothing in federal law that would require NCUA to deplete the reserves of the entire credit union industry. In the unlikely case of catastrophic losses to the NCUSIF, the Board would go to Congress for it to fulfill its full faith and credit pledge before depleting the reserves of healthy credit unions. This is exactly what the Federal Savings and Loan Insurance Corporation did during the savings and loan crisis.

Many credit unions submitted a virtually identical comment on the proposal to amend the current language in the form notice and ballot to state that ''[t]he basic federal coverage is up to $100,000, but accounts may be structured in different ways, such as joint accounts, payable-on-death accounts, or IRA accounts, to achieve federal coverage of much more than

$100,000.'' These commenters believe the proposed notice and ballot unfairly incorporates language about achieving greater federal insurance coverage but prohibits a credit union from giving its members any positive information about private share insurance or the private share insurer. According to these commenters, this will leave the members grossly uninformed. The Board disagrees with this comment. Nowhere in the proposed rule does it prohibit any communication that is not deceptive or misleading. Subject to this standard, a converting credit union is free to provide its members any information that it wants about the private insurer, the insurance coverage, and the reasons for conversion. There is even a place in the form notice for a credit union to do this.

One commenter was concerned that, while the proposed form notice gives the credit union board an opportunity to provide its reasons for the proposed conversion, there is no place on the ballot to state those reasons. The Board notes that usually the notice accompanies the ballot, so there is no reason to have the reasons for the proposed conversion stated on the ballot. If the converting credit union wishes to amend the ballot, it can seek approval of the regional director to include that language.

One commenter objects to the requirement that the notice list the costs of conducting the vote and associated attorney and consulting fees. This commenter states most of these costs occur before the vote, and cannot be avoided by voting against the conversion. Also, this commenter believes that much of the cost would be associated with complying with NCUA's rules and it would be unfair to associate this cost with private insurance. NCUA believes that members have a right to know about the costs associated with a conversion, whether they are incurred before, during, or after the vote. If the credit union wants to point out in an accurate manner that certain costs were incurred to comply with NCUA's conversion rules, it may do so.

2. Amendment Requiring NCUA To Review and Approve Certain Share Insurance Communications

The currently existing part 708b, that is, as it exists before this final rule takes effect, requires credit unions to use specific language in the notice to members of the pending change in insurance status and associated ballot. 12 CFR part 708b, subpart C. It also requires the approval of the regional director for any modifications to this language and any additional communications concerning insurance coverage included with the notice or ballot. 12 CFR 708b.303. The regional director may not withhold approval unless ''it is determined that the credit union, by inclusion or omission of information, would materially mislead or misinform its membership.'' Id. The proposed rule would have retained the prior approval requirement and the standard of review, but expanded the types of communications subject to prior approval to include all share insurance communications made during the voting period. The purpose of the expanded approval requirement was to ensure that members are accurately informed about the ramifications of the loss of federal insurance coverage and to avoid the types of inaccurate and misleading communications discussed in Section C of this Supplementary Information.

The Board also proposed to amend the current rule to clarify the concept of ''notice.'' Part 708b currently provides that, when the board of directors of a federally-insured credit union adopts a resolution proposing to convert from federal to nonfederal insurance, including an insurance conversion associated with a merger or conversion of charter, it must provide its members with written notice of the proposal to convert insurance and of the date set for the membership vote. To ensure that members are adequately informed about the nature of the insurance conversion, the proposal, like the current rule, prescribed specific forms for this notice. The proposed rule made clear that the first written communication following the resolution to convert, made by or on behalf of the credit union and informing the members that the credit union will seek conversion of insurance, is, in fact, the notice of the proposal to convert and must be in the prescribed form unless the regional director approves a different form.

The Board also proposed to add a cross-reference to § 740.2 of NCUA's advertising regulation, which prohibits the making of false or deceptive representations. 12 CFR 740.2. This cross-reference does not create any new requirement, but, rather, reminds credit unions of an important preexisting obligation.

Several commenters support the proposed prior approval requirements. One of these commenters, an SSA, believes the proposed rule is necessary to ensure that adequate disclosure is provided to members before a conversion vote. This commenter believes it is not clear that members are made fully aware of how such a vote may impact their shares. This SSA believes the proposed rule will provide for more standardization in disclosures and is necessary to ensure that adequate disclosure is provided to members before a conversion vote. Another commenter stated the proposed rule will help prevent deception of members and other evasive or misleading practices.

Many credit unions submitted a virtually identical comment on the preapproval requirements. These commenters complained that NCUA was prohibiting converting credit unions from providing their members with any information regarding share insurance before, during, or after the voting period, unless the communications have been pre-approved by NCUA. These commenters feel members will not fully understand the private share insurance option that they are being asked to vote on.

Several commenters are also concerned about how the preapproval process would work. Some of these commenters state there should be a procedure for resolving disputes between the credit union and NCUA over proposed communications. Some of these commenters also stated there should be parameters as to how long the NCUA may take in the review process. A few commenters thought there should be an appeal process, and one of these commenters stated the state regulators should have a role in the appeal process.

A law firm commenter states that both the current and the proposed share insurance conversion rules requiring prior approval of certain communications and mandating disclosures are violations of the right to free speech under the First Amendment to the U.S. Constitution.

A few commenters state that the proposed definition of a share insurance communication is overbroad. For example, two commenters contend that the prior approval requirement in the proposed rule would apply to internal communications at a credit union. One of these questioned if ''a credit union would violate the rules if it even distributed a private insurer's brochure to two board members for a consideration of placing the topic on the board's agenda.'' Another commenter supported NCUA's formal approval of changes to the notice and ballot, but thought that the proposed requirement to approve other share insurance communications would require NCUA approval of individual letters sent in response to member inquiries if any two or more of the letters had substantially the same information.

One commenter complained that requirement that the notice to members

of the pending conversion and member vote be mailed to the members not less than seven days, nor more than 30 days, before the vote, is too restrictive. This commenter believes the time period should be extended from a minimum of 7 days to a maximum of 120 days to allow sufficient time to obtain the necessary twenty percent quorum.

One commenter believes NCUA should not preapprove communications, but ''if a communication is later deemed incorrect in its facts, then the NCUA can take the appropriate action.''

The Board disagrees that the proposed prior approval requirement is a violation of the First Amendment of the U.S. Constitution. Share insurance communications are commercial speech. While the U.S. Supreme Court has recognized that some commercial speech may be protected under the First Amendment, it generally permits interference with commercial speech when the government's motive is to prevent false or misleading speech. *See Central Hudson Gas & Electric Corp.* v. *Public Service Commission of New York,* 447 U.S. 557, 566 (1980) (''At the outset, we must determine whether the expression is protected by the First Amendment. For commercial speech to come within that provision, it at least must concern lawful activity and not be misleading.''). Here, NCUA is specifically targeting inaccurate and misleading commercial speech.

Nevertheless, after careful consideration of the comments, the Board has decided to modify the preapproval requirement as stated in the proposed rule to a contemporary notice requirement, as suggested by the last commenter above. The final rule, as adopted, allows converting credit unions to make share insurance communications without receiving any prior approval. The converting credit unions need only provide NCUA a copy of the share insurance communication at or before the time it is made. The definition of share insurance communication specifically excludes the forms in subpart C and the final rule retains the requirement in the prior rule and as proposed that any modifications to the forms requires the approval of the regional director.

The Board is making this change for several reasons. First, the Board is sympathetic to the burden a preapproval requirement puts on a converting credit union, particularly those credit unions whose share insurance communications are straightforward. As noted in the comments above, the preapproval requirement injects uncertainty into the sequence and timing of the conversion. Also, if the credit union must make an unanticipated communication on short notice, a preapproval requirement could be particularly burdensome. Second, the Board hopes that the modified and additional disclosures will adequately inform credit union members about important aspects of the conversion and any additional communications about share insurance will not contain misleading information. For example, as one commenter pointed out, a converting credit union may send out short messages that merely exhort their members to vote on the share insurance proposal. The Board also realizes that some communications about why a credit union is converting may be expressions of opinion that do not contain anything false or misleading.

Accordingly, the Board is replacing the preapproval requirement with a simple notice requirement. A converting credit union must provide NCUA a copy of any share insurance communication the credit union will make during the voting period. The regional director must receive the copy at or before the time the credit union makes it available to members. The converting credit union must also inform the regional director when the communication is to be made, to which members it will be directed, and how it will be disseminated.

Although the final rule does not require prior NCUA approval for share insurance communications, the final rule clarifies that, if a converting credit union makes a materially misleading communication to its members, the regional director may take appropriate action, including disapproval of the conversion. Of course, the NCUA is willing to work with any credit union to achieve language that is not misleading. A converting credit union may, at its option, provide an advance copy of any proposed share insurance communication to the regional director for review and comment.

In response to comments about the definition of share insurance communications being overbroad, the Board did not intend for the definition to include internal credit union communications, and the definition of ''share insurance communication'' in the final rule is modified to exclude such communications. Also, if a credit union anticipates it will receive multiple member inquiries with the same or similar question about insurance conversion and anticipates a similar response to all inquiries, it should provide NCUA contemporaneous notice of its response.

In response to the commenter who requests more than thirty days to conduct the vote following the credit union's resolution to convert, the Board notes that this maximum time period is statutory and cannot be changed by regulation. 12 U.S.C. 1786(d)(2). The credit union may, before it resolves to convert, inform its members about the possibility of a resolution to convert and the attendant vote. Any such communication must contain the appropriate disclosures and not otherwise mislead the members.

3. Amendments Relating to the Timing and Sequence of the Conversion Approval Process

Currently, part 708b requires that NCUA must approve a merger before the members vote. By contrast, for insurance conversions, part 708b provides two options as to when a credit union must give notice: ''Notice to the Board may be given when membership approval is solicited, or after membership approval is obtained.'' *Compare 12* CFR 708b.106(a)(1) (mergers) *with* § 708b.203(c) (conversions). These different provisions may create confusion in mergers that also involve insurance conversions. NCUA proposed to eliminate this confusion by changing the notice requirement for insurance conversions to require a converting credit union to notify NCUA and request approval of the conversion before the credit union solicits a member vote.

Many credit unions submitted a virtually identical comment on this proposal. These commenters believe that this change to the proposed regulation would require a converting credit union to gain NCUA's approval twice: once before the member vote, and then again after the member vote. These commenters believe this unfairly takes the decision out of the hands of the members and places it with NCUA.

One commenter supports the proposed rule and believes that, by adjusting the share insurance notification requirement to match the notification requirement in mergers, it will help achieve NCUA's goal of helping to eliminate the confusion present in current part 708b.

The final rule adopts the proposed amendment with one minor change. The Board is adding a sentence at the end of § 708b.203(c) to clarify that, while a credit union must give NCUA notice of its intent before the member vote is solicited, NCUA will only approve or disapprove the proposed conversion once. The Board will generally make its decision after the credit union has certified the member vote to the NCUA as specified in § 708b.203(g).

4. Amendment Allowing Members to Redeem Term Share Accounts Without Penalty

The proposed rule required, as part of the conversion process, that a credit union inform its members in the form notice of member vote that, if the conversion is approved, it will permit members to close share certificate and other term accounts without penalty if done before the effective date of conversion. The proposal was based on the Board's belief that, as a matter of contract law and fundamental fairness, members who entered into term accounts that were federally insured should be given the opportunity to withdraw their funds without penalty if the accounts lose their federal insurance.

A few commenters support the proposed amendment. One of these commenters states that, if a credit union changes its own terms and conditions, members who relied upon the original terms and conditions should be allowed a way out of their contract.

Many credit unions submitted a virtually identical comment in opposition to the proposed amendment. These commenters believe allowing for early withdrawals without penalty is unsafe, unreasonable and unnecessary, and could create a fear in the membership that results in a run on a federally-insured credit union. These commenters also believe this amendment is an effort to sway the vote away from private insurance.

The Board does not believe the amendment will create a run on any institution or is otherwise unsafe and unsound. The Board notes many of the commenters who opposed portions of the proposed rule were credit unions that have already converted to private share insurance. Some of these commenters discussed the effect on their membership of the conversion. All of these commenters claimed that the number of members who complained or left the credit union because of the conversion was insignificant.

Further, the Board does not intend the right of penalty-free early withdrawal to be used to sway members to vote against the conversion. The proposed rule would have required converting credit unions to provide members information about penalty-free withdrawals twice: once in the notice of proposal to convert that precedes the member vote and again, stated conspicuously, in the notice to members that the conversion has been approved. This final rule allows converting credit unions to delete this information from the form notice of proposal to convert (§ § 708b.301(b), 708b.302(b), and 708b.303(b)). If the conversion is approved, however, the credit union must still inform its members in a conspicuous fashion about the right to penalty-free withdrawals as provided in § 708b.204(c)(2). With this change in the final rule—from two required notices of the right to early withdrawal to only one required notice—the Board wants to ensure that members read the important information in the one required notice and have time to act on it. Accordingly, the final rule makes three modifications to the § 708b.204(c)(2) notice: First, to define conspicuous in this context to mean bolded and no smaller than any other font size used elsewhere in the notice; second, to require that the statement appear on the first page of the notice; and, third, to provide that the credit union must deliver the notice at least 30 days before the effective date of the conversion.

One commenter stated the proposed requirement to allow early withdrawals on term accounts without penalty is an unconstitutional interference with contracts in violation of the U.S. Constitution (Art. I, Section 9) and the Constitution of the State of Illinois (Art. I. Section 6). The Board disagrees. There is no legal impediment to the proposed amendment. Federal share insurance is an implied or express condition of any term share account contract opened at a federally-insured credit union. NCUA regulations, for example, require that the official NCUA sign be displayed at any location where the credit union receives shares. The sign clearly indicates to a would-be share purchaser that he or she will be receiving federal insurance on the account.

One commenter who opposed the requirement stated that ''if the member is that concerned about the safety and soundness of his shares, he will most likely be willing to suffer the penalty to retrieve them.'' The Board disagrees. Some members, particularly elderly members, may have their life savings at the credit union and may be the least able to afford the payment of a penalty.

One commenter asked about members who have deposit balances in excess of NCUA share insurance and if the credit union would only have to waive the penalty associated with the federally-insured portion of the funds. The Board agrees that only the federally-insured portion of the accounts should be subject to withdrawal without penalty and has modified the language of the final rule to reflect this.

One commenter stated, ''Giving carte blanche to the members to withdraw the funds from certificates or any term accounts at any time after the conversion in effect makes all the accounts demand accounts for their remaining term. At a minimum this should occur within a preset time period, for instance 90 days after the conversion.'' This commenter misread the proposed rule. The Board has modified the language of the final rule slightly to state more clearly that penalty free withdrawals are only available between the time the conversion is approved and the time that it takes effect. The Board has also added a phrase to clarify that members must request any withdrawals during this time frame.

One SSA suggested that NCUA and the credit union should be able to continue to provide federal insurance for those members concerned about their term accounts. The Board believes there are both legal and policy impediments to a partial insurance arrangement and declines to adopt it.

5. Amendment Requiring Converting Credit Unions To Provide Proof of Eligibility for Nonfederal Insurance

Not all states permit nonfederal primary share insurance. The proposed rule would require, as part of the request for NCUA approval of conversion to nonfederal insurance, that the converting credit union provide proof that the nonfederal insurer is authorized to issue share insurance in the state where the credit union is located and that the insurer will insure the credit union. Several commenters questioned the need for this requirement. The Board believes proof of these facts avoids the possibility of a credit union seeking to convert to private insurance for which it is not eligible. Accordingly, the final rule includes the proposed amendment.

6. Amendment Requiring a Secret Member Vote Conducted by an Independent Entity

To ensure the integrity of the vote, the proposed rule required the vote be conducted by secret ballot and be administered by an independent entity. The proposed rule defined ''independent entity'' as a company with experience in conducting corporate elections.

A few commenters support the use of an ''independent entity'' and a secret ballot for votes on insurance issues to ensure the integrity of the vote. One of these commenters supports the proposal to ensure issues of impropriety are not levied against the credit union's management or its board at a later date with respect to the vote.

Many credit unions submitted a virtually identical comment in opposition to the proposed amendment. These commenters believe there is no reason to conduct conversion votes any differently from credit union election votes where the credit union's supervisory committee or independent certified public accountant assumes the responsibility for the accuracy and reporting of the vote. These commenters state the new requirement will increase the cost of the conversion vote and implies mistrust of a board of directors to conduct an accurate and honest vote. These commenters note that NCUA seldom audits conversion votes and has never challenged a conversion vote.

Several commenters also stated the requirement is onerous, particularly for small credit unions. One commenter wrote that it is highly unlikely that the independent entity conducting the vote will attest to the accuracy of the credit union's count of the total number of members.

The final rule retains the secret ballot and independent teller requirements. These requirements will help ensure the integrity and accuracy of the conversion vote. The Board does not believe these requirements are onerous and notes that the private insurer assists converting credit unions, including small credit unions, during the conversion process. Also, if the credit union is maintaining up-to-date records of its membership, the Board believes both the credit union and the independent entity should be able to certify the number of members at the credit union. If there is some question about the exact number, but the range of possible error is not material to the outcome of the vote, the credit union and independent entity may footnote the certification and attach a detailed explanation.

One commenter stated that the 20% quorum requirement is overly burdensome, and another commenter incorrectly stated that the requirement was NCUA-imposed. The Act, not NCUA, imposes the 20% quorum requirement. 12 U.S.C. 1786(d)(2). One commenter complained that the requirement that the notice to members of the pending conversion and member vote be mailed to the members not less than seven days, nor more than 30 days, before the vote, was too restrictive. This requirement is also imposed by the Act. *Id.*

7. Miscellaneous Amendments

The proposed rule would also have clarified that the terms ''insurance'' and ''insured'' as used in part 708b refer to primary share or deposit insurance, not to excess insurance. The proposed rule would also have made other minor changes to modernize the language of the rule. There were no comments received specifically on these amendments, and the final rule adopts them as proposed.

F. Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under ten million dollars in assets). Each year, there are about 300 mergers that involve federally-insured credit unions, and about 250 of these mergers involve small credit unions. In almost all cases, however, the small credit union merges into a much larger continuing credit union. The larger credit union is available to assist the small credit union with each step in the merger process, keeping the economic impact on the small credit union to a minimum. In addition, there are only one or two small credit unions a year on average that undertake an insurance conversion, and the private insurer assists these converting credit unions with the conversion process. Accordingly, the Board certifies that this final rule will not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

Section 708b contains information collection requirements. As required by the Paperwork Reduction Act of 1995, 44 U.S.C. 3507(d), NCUA submitted a copy of this proposed rule as part of an information collection package to the Office of Management and Budget (OMB) for its review and approval for revision of Collection of Information, Mergers of Federally Insured Credit Unions, Control Number 3133–0024. OMB approved the Collection of Information on October 7, 2004.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. One commenter stated that the proposed requirement for state chartered credit unions to obtain the prior approval of the state supervisory authority (SSA) of share insurance communications, in tandem with NCUA, would impose a tremendous burden on the SSA with implications under Executive Order 13132. As the final rule eliminates any requirement for NCUA prior approval, it also eliminates any requirement for the prior approval of SSAs. Accordingly, the final rule will not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 708b

Credit Unions, Mergers of Credit Unions, Reporting and Recordkeeping Requirements.

By the National Credit Union Administration Board on January 13, 2005.

Mary Rupp,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708a

Conversion of Insured Credit Unions to Mutual Savings Banks

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is updating its rule regarding conversion of insured credit unions to mutual savings banks (MSBs). The amendments require a converting credit union to provide its members with additional disclosures about the conversion before conducting a member vote. The amendments also require the vote to be by secret ballot and conducted by an independent entity. Finally, the amendments require a federally-insured State credit union to provide NCUA with conversion related information about the law of the State where the credit union is chartered.

DATES: This final rule is effective January 28, 2005.

FOR FURTHER INFORMATION CONTACT: Frank S. Kressman, Staff Attorney, at (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

The Credit Union Membership Access Act (CUMAA) was enacted into law on August 7, 1998. Public Law 105–21. Section 202 of CUMAA amended the provisions of the Federal Credit Union Act concerning conversion of insured credit unions to MSBs. 12 U.S.C. 1785(b). CUMAA required NCUA to promulgate final rules regarding charter conversions that were: (1) Consistent with CUMAA; (2) consistent with the charter conversion rules promulgated by other financial regulators; and (3) no more or less restrictive than rules applicable to charter conversions of other financial institutions. NCUA issued rules in compliance with this mandate. 63 FR 65532 (November 27, 1998); 64 FR 28733 (May 27, 1999).

Since the enactment of CUMAA, NCUA has become concerned that many credit union members do not appreciate the effect a conversion may have on their ownership interests in the credit union and voting power in the MSB. In February 2004, NCUA amended part 708a to require a converting credit union to disclose additional information to its members to better educate them regarding the conversion. 69 FR 8548 (February 25, 2004). NCUA solicited public comment as part of that rulemaking. Some commenters suggested that, among other things, NCUA should have imposed more disclosures and requirements on converting credit unions. Many offered specific suggestions. NCUA noted at that time that many of those suggestions deserved further consideration but were beyond the scope of that rulemaking and would have to be considered in a future rulemaking. In July 2004, NCUA issued a proposed rule with request for comments to address some of those suggestions and other ongoing concerns NCUA has in connection with protecting members' interests in the conversion process. 69 FR 46111 (August 2, 2004).

B. Discussion

CUMAA provides that an insured credit union may convert to an MSB without the prior approval of NCUA, but it also requires NCUA to administer the member vote on conversion and review the methods and procedures by which the vote is taken. This is reflected in NCUA's conversion rule. The rule requires a converting credit union to provide its members with written notice of its intent to convert. 12 CFR 708a.4. It also specifies that the member notice must adequately describe the purpose and subject matter of the vote on conversion. *Id.* In addition, a converting credit union must notify NCUA of its intent to convert. 12 CFR 708a.5. The credit union must provide NCUA a copy of its member notice, ballot, and all other written materials it has provided or intends to provide to its members in connection with the conversion. *Id.*

A converting credit union has the option of submitting these materials to NCUA before it distributes them to its members. *Id.* This enables the credit union to obtain NCUA's preliminary determination on the methods and procedures of the member vote based on NCUA's review of the written materials. NCUA believes its review of these materials is a practical and unintrusive way of fulfilling, at least part of, its congressionally mandated responsibility to review the methods and procedures of the vote.

If NCUA disapproves of the methods and procedures of the member vote after the vote is conducted, then NCUA is authorized to direct a new vote be taken. 12 CFR 708a.7. NCUA interprets its responsibility to review the methods and procedures of the member vote to include determining that the member notice and other materials sent to the members are accurate and not misleading, all required notices are timely, and the membership vote is conducted in a fair and legal manner.

A charter conversion has consequences that may not surface for a number of years and are often not apparent at the time of conversion to even the most astute members. As a result, members cannot make an informed decision about how the conversion will affect them unless their credit union provides them with this information.

NCUA is aware that credit unions are not providing some important conversion related information effectively to their members. This limits members' ability to make informed decisions about a conversion. NCUA also has become aware that many credit unions may not be equipped to conduct a proper member vote on conversion. Accordingly, NCUA is amending the conversion rule to require a converting credit union to provide additional disclosures to its members. Also, NCUA is providing guidelines to help converting credit unions better understand how they can satisfy the regulatory standard that the member vote be conducted in a fair and legal manner. In addition to the guidelines, NCUA is amending the rule to require the vote be conducted using secret ballots and an independent teller to ensure the integrity of the voting process and the privacy of each member's vote. Finally, NCUA is amending the conversion rule to require a federally-insured State credit union to provide NCUA with information about how the law of the State under which it is chartered relates to NCUA's conversion rule so that NCUA's review of the methods and procedures of the vote includes ensuring compliance with applicable State law.

C. Disclosures

A converting credit union can provide information to its members regarding any aspect of the conversion in any format it wishes, provided all communications are accurate and not misleading. NCUA only requires certain, minimal information be provided in the notice to members. Most converting credit unions choose to provide a great deal more information and, while NCUA recognizes this is a way to educate members, NCUA is concerned that members may be overwhelmed by the great volume of information. NCUA does not, however, wish to dissuade converting credit unions from communicating with their members or limit those communications.

To balance these competing interests, NCUA will continue to allow a converting credit union to communicate with its members as it sees fit, but will require that members receive a short, simple disclosure prepared by NCUA. This disclosure addresses: (1)

Ownership and control of the credit union; (2) operating expenses and their effect on rates and services; (3) the effect of a subsequent conversion to a stock institution; and (4) the costs of conversion. NCUA believes members need to be particularly aware of these topics. NCUA recognizes these topics might be discussed elsewhere in a credit union's communications with its members, but NCUA is concerned that this information may get buried in the great volume of information being provided. Accordingly, a converting credit union must include this disclosure in a prominent place with each written communication it sends to its members regarding the conversion and must take specific steps to ensure that the disclosure is conspicuous to the member. To promote flexibility, a converting credit union may modify the disclosure with the prior consent of the Regional Director and, in the case of a State credit union, the appropriate State supervisory authority (SSA).

Officials of many converting credit unions indicate in their conversion materials that they are unable to raise capital quickly enough to operate their credit unions as they see fit, which often includes a desire to pursue rapid growth. These credit unions encourage their members to support the conversion to an MSB as a way to overcome this capital restraint. They do not, however, inform their members that the conversion process can be expensive and further deplete a credit union's capital. NCUA believes members deserve to know how much of their money will be spent on the conversion effort. Accordingly, NCUA is amending the conversion rule to require converting credit unions to disclose the costs of conversion as part of the above disclosure requirements. An accurate cost estimate must take into account conversion related expenses including printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, conducting the vote, and other related expenses.

D. Guidelines for Conducting a Member Vote

A converting credit union must conduct its member vote on conversion in a fair and legal manner. A vote that does not satisfy this standard denies members their democratic right to decide the fate of their credit union and could result in a charter change without the true support of the members. The final rule includes guidelines to avoid these kinds of undesirable results. The guidelines address topics such as: (1) Understanding the relationship between Federal and State law; (2) determining voter eligibility; (3) holding a special meeting.

NCUA does not purport these guidelines are an exhaustive checklist that guarantees a fair and legal vote. Rather, the guidelines are suggestions that provide a framework that, if followed, will help a credit union fulfill its regulatory obligations. A converting credit union should use these guidelines in conjunction with its own independent analysis and planning to tailor the member vote to its particular circumstances.

E. Relationship Between State and Federal Law

Although NCUA's conversion rule applies to all conversions of federally-insured credit unions, federally-insured state credit unions may also be subject to State law on conversions. As stated in previous rulemakings, NCUA's position is that a State legislature or SSA may impose conversion requirements more stringent or restrictive than NCUA's. This position is included in the final rule. In fact, NCUA understands over half the States do not specifically permit conversions of credit unions to MSBs. Reflecting NCUA's support of the dual chartering system, NCUA will defer to a State regulator when appropriate on questions involving interpretation of State law.

When State law applies to a conversion, it can change the procedural and substantive requirements a converting credit union must satisfy. NCUA needs to understand how State law affects those requirements to fulfill its responsibility to review the methods and procedures of the member vote. Accordingly, NCUA requires a federally-insured state credit union to notify NCUA if the State law under which it is chartered permits it to convert to an MSB. The credit union also must inform NCUA if it relies for its authority to convert on a State law parity provision, a provision permitting a state credit union to operate with the same or similar authority as a federal credit union (FCU), and if its State regulatory authority agrees that it may rely on the parity provision for that purpose. Finally, if a federally-insured state credit union relies on a state parity provision for authority to convert, it is required to indicate its State regulatory authority's position as to whether Federal law or State law will control internal governance issues in the conversion such as the requisite membership vote for conversion and the determination of a member's eligibility to vote.

F. Secret Ballots and Third Party Tellers

NCUA understands that members, including those that are employees of the credit union, may be uncomfortable with a voting process that does not protect the privacy of their votes. NCUA is concerned this may lead some members to choose not to vote or to vote in a manner inconsistent with their true wishes. Accordingly, the final rule protects members' privacy by requiring a converting credit union to use a secret ballot and an independent entity to conduct the vote. NCUA requires that a converting credit union use a third party teller to conduct the vote meaning that a third party teller will be responsible for sending ballots, receiving and safe keeping ballots, verifying ballots, and tabulating the vote. Use of a third party teller enhances the integrity of the voting process and provides confidence that members, including employees, will have their votes remain confidential.

G. Written Materials

Since CUMAA, the conversion rule has required a converting credit union to provide NCUA with copies of all written materials it sends or intends to send to its members in connection with the conversion proposal. NCUA is not changing that requirement but is clarifying that it applies to all written materials, including electronic communications posted on Web sites.

H. Summary of Comments

NCUA received 42 comments regarding the proposed rule. Thirty commenters supported the proposal. One so strongly that it stated it was ''criminal'' for credit unions to convert and strip out of the credit union the reserves accumulated over time by many members and put them ''into the pockets of a very few individuals.'' All of the nine commenters who are members of a credit union whose recent conversion campaign failed supported the proposal and many of them indicated that, if the terms of the proposal were in place when their credit union was considering converting, they would have been better informed or the process would have been fairer to members.

Many of the proposal's supporters offered suggestions to improve the rule. For example, ten commenters offered various suggestions to revise the proposed disclosures. Six commenters suggested there should be more required disclosures beyond those proposed.

One of those commenters suggested that paid consultants and service

providers be identified to the members and be required to disclose if they have opened an account at the credit union as a result of their involvement in the conversion. One of the conversion consultants stated that, if the costs of the conversion are to be disclosed, then the credit union should identify the name of the recipients of expenditures. NCUA believes the portion of the proposal that requires a converting credit union to disclose an itemized estimate of the costs of the conversion to its members helps to provide members with necessary information to understand and cast an informed vote on the conversion. NCUA also believes the suggestion that NCUA require a converting credit union to identify by name the recipients of expenditures as part of a detailed itemization of costs is worthy of further consideration. That requirement, however, as well as disclosure of the accountholder status of paid consultants and service providers, are beyond the scope of the proposal and are not adopted in this final rule.

One commenter suggested NCUA provide more voting guidelines than proposed. Another asked NCUA to clarify ''the extent to which the guidelines would be enforced.'' NCUA reiterates the voting guidelines are not regulatory requirements subject to enforcement. Rather, they are suggestions intended to help converting credit unions fulfill their regulatory obligation of conducting its member vote in a fair and legal manner.

Nine commenters stated that the proposed disclosure, which states ''Credit union directors and committee members serve on a volunteer basis,'' is not completely accurate because a number of States allow credit unions to compensate their board members while others are silent on the issue. NCUA is amending the disclosure to reflect these comments.

Seven commenters stated a converting credit union should not be legally required to use Robert's Rules of Order to conduct its special meeting on conversion or suggested there be flexibility to use other parliamentary procedures. One of these commenters also suggested NCUA require a converting credit union to hire an independent parliamentarian to run the meeting. Another commenter did not mention Robert's Rules of Order, but recommended the use of a certified parliamentarian. NCUA discusses the use of Robert's Rules of Order in the voting guidelines section of the proposal. As noted above, the guidelines are not regulatory requirements, and, therefore, a converting credit union is not legally required to follow them including using Robert's Rules of Order in conducting its special meeting relating to the member vote. NCUA recommends, however, that a converting credit union use appropriate parliamentary procedures to conduct its vote, and should enlist the services of an individual knowledgeable and skilled in those procedures. NCUA is revising the voting guidelines to clarify that Robert's Rules of Order are not the only parliamentary procedures a credit union should consider using for its member vote.

Twelve commenters, including the conversion consultants, banking trade organizations, and a bank that was formerly an FCU that had converted to an MSB and subsequently converted to a stock bank, opposed the proposal in general, stating it is inconsistent with CUMAA or obstructs credit unions' right to convert. NCUA fully supports a credit union's right to convert its charter but notes this right belongs to the members of the credit union. Members can only exercise that right in a meaningful way if their credit union provides them with information that is accurate and not misleading. NCUA is aware of the limitations CUMAA places on its authority to approve a conversion but is mindful of its responsibility to oversee the methods and procedures applicable to the member vote on conversion and protect the interests of credit union members.

Some of the commenters who opposed the proposal:

<bullet≤ Believe the disclosure regarding voting rights is inaccurate because an MSB could choose a ''one vote per member'' policy instead of allotting votes based on account balances,

<bullet≤ Highlighted that an MSB to stock conversion requires a number of steps scrutinized by other regulators and stated the disclosure regarding subsequent conversion to a stock institution is misleading and intended to discourage credit union members from voting for the conversion to an MSB,

<bullet≤ Believe NCUA acknowledges the proposal is intended to discourage conversions because NCUA reduced the estimated number of conversions per year in a Paperwork Reduction Act (PRA) filing associated with the proposed rulemaking, and

<bullet≤ Suggested the proposed requirement on state credit unions to provide NCUA with information about State laws affecting the conversion is burdensome or indicated NCUA does not have confidence in SSAs to perform their functions.

The fact that MSBs could choose a ''one vote per member'' policy instead of allotting votes based on account balances is not what MSBs, in fact, usually choose to do. The disclosure regarding voting rights states that, in an MSB, account holders with larger balances ''usually'' have more votes and, thus, greater control. NCUA believes this is an accurate statement. Also, NCUA recognizes that additional steps and member votes are required to approve an MSB to stock institution conversion. This does not lessen NCUA's concern about protecting credit union members' interest in their credit union. Those additional steps and member votes, although possibly scrutinized by other regulators, occur only after the credit union has converted to an MSB and is on its way to converting to the stock form of ownership. Obviously, at that point, the credit union does not exist and the additional requirements can do nothing to enable a credit union member to make an informed decision on the initial conversion from a credit union to an MSB.

The disclosure regarding subsequent conversion to a stock institution is not misleading and not intended to discourage credit union members from voting for the conversion to an MSB. It states that, in a typical conversion to the stock form of ownership, the executives of the institution profit by obtaining stock far in excess of that available to the institution's members. This accurately reflects an executive's ability to obtain stock options, restricted stock or other forms of stock related compensation not available to members not employed by the credit union.

In the normal course of the rulemaking process, NCUA submitted a required PRA filing. In that filing, NCUA reduced the estimated number of conversions per year from a previous submission based on its experience with conversions over the past several years. NCUA would have made the same reduction in the PRA filing based on historical data even if this rule were not being considered.

The requirement on state credit unions to provide NCUA with information about State laws affecting the conversion is not burdensome and does not indicate any lack of confidence in SSAs to perform their functions. NCUA fully acknowledges that a State legislature or SSA may impose conversion requirements more stringent or restrictive than NCUA's. As noted above, when State law applies to a conversion, it can change drastically the procedural and substantive requirements a converting credit union

must satisfy. It is essential for a converting credit union to understand both Federal and State requirements for compliance purposes and for NCUA to do the same to fulfill its responsibility to review the methods and procedures of the member vote as affected by State law. NCUA does not believe it is burdensome for a converting credit union to inform NCUA of State law that the credit union must obtain in any event to assure compliance with all applicable laws. NCUA works closely and cooperatively with SSAs in processing conversions and defers to SSAs in making determinations regarding State law. NCUA believes the subject requirement helps to promote cooperation among the regulators and a more informed converting credit union.

Three commenters disagreed with NCUA's statement that no conversion vote can be fair and legal if some members are improperly excluded. These commenters stated there is no statutory requirement for perfection and that a certain percentage of member exclusions should be tolerated if not the result of wrongful intent on the part of the converting credit union. Since CUMAA, NCUA has disapproved a converting credit union's methods and procedures applicable to the member vote on only one occasion. In that situation, voter disenfranchisement was widespread. NCUA will continue to take a pragmatic approach in reviewing member votes on conversion.

One commenter suggested a converting credit union should be required to prepare a comprehensive three-year business plan for the converted institution similar to the plan required by 12 CFR part 563b for MSBs proposing to convert to stock form. This commenter also stated the plan should be required to be sent to the credit union's members with the notice of intent to convert or the notice should explain how a member can obtain a free copy of the plan. This suggestion is beyond the scope of the proposal, but NCUA will consider it for future inclusion in the conversion rule.

Finally, commenters to previous amendments to the conversion rule have recommended NCUA require converting credit unions to provide members a meaningful way to share their opinions on the conversion and to disclose the views and concerns of the credit union's directors and officers who oppose the conversion. Four commenters to this rulemaking suggested there should be some mechanism in place for members to share their opinions on the conversion with each other and the credit union during the process. NCUA will continue to consider if this is practical and valuable and if it could be accomplished with minimal regulatory burden.

I. Effective Date of Final Rule

Generally, a final rule promulgated by NCUA is effective 30 days following its publication in the **Federal Register**. This final rule, however, is effective immediately upon publication because there is a strong public interest in having this consumer protection rule in place. First, this is necessary to ensure crucial disclosure information is provided to credit union members whose credit union has initiated or is about to initiate the conversion process, so the members may cast an informed and educated vote on the future existence of their credit union and their stake in it. Second, this will provide regulatory certainty to credit unions that are considering converting or beginning the conversion process within the next thirty days and enable them to better understand the regulatory requirements they must follow throughout the entirety of the process.

A converting credit union is required by statute and regulation to provide notice of its intent to convert to its members 90 days, 60 days, and 30 days before the member vote on conversion. 12 U.S.C. 205(b)(2)(C); 12 CFR 708a.4(b). It would be confusing for a converting credit union and its members if this rule became effective during that 90-day period as that would alter the regulatory requirements of the conversion in mid-process. That confusion about which regulatory requirements must be followed at a given point in the conversion process is eliminated for any recently initiated, soon to be initiated, and future conversions by making this rule immediately effective. Accordingly, for good cause, NCUA finds that, pursuant to 5 U.S.C. 553(d)(3), it would be impracticable and contrary to the public interest to delay the effective date of this rule for 30 days following publication. Therefore, this rule is effective immediately upon publication.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small credit unions, defined as those under ten million dollars in assets. This final rule amends the procedures an insured credit union must follow to convert to an MSB. Slightly over twenty credit unions have converted since 1995. NCUA anticipates no more than five credit unions per year will convert in the future and it is unlikely that any will have less than ten million dollars in assets. Accordingly, the amendments would not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

Part 708a contains information collection requirements. As required by the PRA, 44 U.S.C. 3507(d), NCUA previously submitted a copy of this regulation in proposed form as part of an information collection package to the Office of Management and Budget (OMB) for its review and approval of a revision to Collection of Information, Conversion of Insured Credit Unions to Mutual Savings Banks, Control Number 3133–0153.

NCUA estimated the average annual burden per converting credit union to be between 20 and 23 hours and that no more than five credit unions will convert per year. As a result, NCUA estimated the total annual collection burden to be no more than 115 hours. NCUA did not receive any comments addressing the accuracy or methodology for computing the burden. OMB approved the revision.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on State and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The final rule would not have substantial direct effects on the States, on the connection between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 708a

Charter conversions, Credit unions.

By the National Credit Union Administration Board on January 13, 2005.

Mary F. Rupp,

Secretary of the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

Loan Interest Rates

AGENCY: National Credit Union Administration.

ACTION: Final rule.

SUMMARY: The current 18 percent per year federal credit union maximum loan rate is scheduled to revert to 15 percent on March 9, 2005, unless otherwise provided by the NCUA Board (Board). A 15 percent ceiling would restrict certain categories of credit and adversely affect the financial condition of a number of federal credit unions. At the same time, prevailing market rates and economic conditions do not justify a rate higher than the current 18 percent ceiling. Accordingly, the Board hereby continues an 18 percent federal credit union loan rate ceiling for the period March 9, 2005 through September 8, 2006. The Board is prepared to reconsider the 18 percent ceiling at any time should changes in economic conditions warrant.

DATES: Effective February 28, 2005.

FOR FURTHER INFORMATION CONTACT: Daniel Gordon, Senior Investment Officer, Office of Strategic Program Support and Planning, at the National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428, or telephone (703) 518–6620.

SUPPLEMENTARY INFORMATION:

Background

Public Law 96–221, enacted in 1980, raised the loan interest rate ceiling for federal credit unions from one percent per month (12 percent per year) to 15 percent per year. 12 U.S.C. 1757(5)(A)(vi). The law also authorized the Board to set a higher limit, after consulting with Congress, the Department of Treasury and other federal financial agencies, for a period not to exceed 18 months, if the Board determined that: (1) Money market interest rates have risen over the preceding six months; and (2) prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in growth, liquidity, capital, and earnings.

On December 3, 1980, the Board determined that the foregoing conditions had been met. Accordingly, the Board raised the loan ceiling to 21 percent. In the unstable environment of the first half of the 1980s, the Board lowered the loan rate ceiling from 21 percent to 18 percent, effective May 18, 1987. This action was taken in an environment of falling market interest rates from 1980 to early 1987. The ceiling has remained at 18 percent to the present. The Board believes retaining the 18 percent ceiling will permit credit unions to continue to meet their current lending programs and permit the necessary flexibility for credit unions to react to any adverse economic developments.

The Board would prefer not to set loan interest rate ceilings for federal credit unions. Credit unions are cooperatives and establish loan and share rates consistent with the needs of their members and prevailing market interest rates. The Board supports free lending markets and the ability of federal credit union boards of directors to establish loan rates that reflect current market conditions and the interests of their members.

Congress, however, has imposed loan rate ceilings since 1934, and, as stated previously, in 1980, Congress set the ceiling at 15 percent but authorized the Board to set a ceiling in excess of 15 percent, if conditions warrant. The following analysis justifies a ceiling above 15 percent, but at the same time does not support a ceiling above the current 18 percent. The Board is prepared to reconsider this action at any time should changes in economic conditions warrant.

Money Market Interest Rates

As Table 1 below shows, interest rates on United States Treasury securities have increased in maturities of three years and less, in the six month period June 1, 2004 through November 30, 2004.

Table 1.—Change in U.S. Government Yields

[May 30, 2004–November 30, 2004]

Maturity	Rate 5/30/2004 (percent)	Rate 11/30/2004 (percent)	Change (percent)
3-month	1.06	2.22	1.16
6-month	1.38	2.43	1.05
2-year	2.53	3.00	.47
3-year	3.06	3.25	.19
5-year	3.79	3.69	-.10
10-year	4.65	4.35	-.30

In addition, between June 2004 and November 30, 2004, the Board of Governors of the Federal Reserve System raised the federal funds target rate four times, from 1.00 percent to 2.00 percent. In December 2004, the Federal Reserve raised the federal funds target rate another .25 percent. Statements from Federal Reserve officials indicate that further increases in the federal funds target rate are expected. For example, Anthony M. Santomero, President of the Federal Reserve Bank of Philadelphia, said, ''I think it is fair to say a neutral federal funds policy is above our current level.'' Michael H. Moskow, President of the Federal Reserve Bank of Chicago, said, ''There is certainly more ground to cover on interest rates.''

The forward Treasury curve (Table 2) also anticipates higher rates. The expected increases range from 87 basis points in the 1-year maturity to 34 basis points in the 10-year maturity.

Table 2.—Implied 1-Year Forward Rates

[November 30, 2004]

Maturity	Change one-year forward rate (percent)
1-year	.87
2-year	.57
3-year	.52
5-year	.64
10-year	.34

Financial Implications for Credit Unions

For at least 450 federal credit unions, representing 7.79% percent of reporting federal credit unions, the most common rate on unsecured loans was above 15 percent at year-end 2003. While the bulk of credit union lending is below 15 percent, small credit unions and credit unions that have implemented risk-based lending programs require interest rates above 15 percent to maintain liquidity, capital, earnings, and growth. Loans to members who have not yet established credit histories or have weak credit histories have more credit risk. Credit unions must charge rates to cover the potential of higher than usual losses for such loans.

There are undoubtedly more than 450 federal credit unions charging over 15 percent for unsecured loans to such members. Many credit unions have ''credit builder'' or ''credit rebuilder'' loans but report only the most common unsecured loan rates on NCUA Call Reports. Lowering the interest rate ceiling for federal credit unions would discourage these credit unions from making certain loans and many of the affected members would have no alternative but to turn to other lenders who charge higher rates.

Small credit unions would be particularly affected by lower loan rate ceilings since they tend to have higher levels of unsecured loans, typically with lower loan balances. Table 3 shows the number of federal credit unions in each asset group where the most common rate is more than 15 percent for unsecured loans.

Table 3.—Active Federal Credit Unions With Most Common Unsecured Loan Rates Greater Than 15 Percent

[December 2003]

Peer group by asset size	Total all Federal credit unions	Number of Federal credit unions with greater than 15 percent
$0–2 million	1175	92
$2–10 million	1794	164
$10–50 million	1753	123
$50 million+	1051	71
Total	5773	450

Should the interest rate charged on loans be subject to a 15 percent ceiling, a number of federal credit unions, where the majority of members are low-income, will incur significant financial strain. Approximately 12.65 percent of federal credit unions with low-income designation report loan interest rates greater than 15 percent. In contrast, only 7.79 percent of all credit unions report rates above 15 percent. Approximately 14.33 percent of low-income credit unions with assets less than $10 million would be affected.

These credit unions offset the cost of generating low-balance loans by charging increased interest rates. These credit unions generally are not able to provide credit card loans and, instead, grant closed-ended and open-ended loans with the prerequisite underwriting documentation. Further, these smaller credit unions generally maintain a higher expense ratio, since many are involved with high-transaction accounts requiring higher personnel costs and related operational expenses, and lack economies of scale.

Further, among the 450 federal credit unions where the most common rate is more than 15 percent for unsecured loans, 62 credit unions have 20 percent or more of their assets in this category and all but five credit unions have assets of less than $10 million. For these credit unions, lowering the rates would threaten their liquidity, capital, earnings, and growth.

The Board has concluded that conditions exist to retain the federal credit union interest rate ceiling of 18 percent per year for the period March 9, 2005 through September 8, 2006. Finally, the Board is prepared to reconsider the 18 percent ceiling at any time during the extension period should changes in economic conditions warrant.

Regulatory Procedures

Administrative Procedure Act

The Board has determined that notification and public comment on this rule are impractical and not in the public interest. 5 U.S.C. 553(b)(3)(B). Due to the need for a planning period before the March 9, 2005 expiration date of the current rule, and the threat to the safety and soundness of individual credit unions with insufficient flexibility to determine loan rates, final action on the loan rate ceiling is necessary.

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (those under ten million dollars in assets). This final rule provides added flexibility to all federal credit unions regarding the permissible interest rate that may be used in connection with lending. The NCUA Board has determined and certifies that this rule will not have a significant economic impact on a substantial number of small credit unions.

Paperwork Reduction Act

NCUA has determined that this rule does not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their regulatory actions on state and local interest. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This rule applies only to federal credit unions and, thus, will not have substantial direct effects on the states, on the relationship between the national government and the states, nor materially affect state interests. The NCUA has determined that the rule does not constitute a policy that has any federalism implication for purposes of the executive order.

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for

congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this is not a major rule.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

NCUA has determined that this rule will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105–277, 112 Stat. 2681 (1998).

List of Subjects in 12 CFR Part 701

Credit, Credit unions, Loan interest rates.

By the National Credit Union Administration Board on January 13, 2005.

Mary F. Rupp,

Secretary to the Board.

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 708a

Conversion of Insured Credit Unions to Mutual Savings Banks

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is updating its rule regarding conversion of insured credit unions to mutual savings banks (MSBs). The amendments require a converting credit union to provide its members with additional disclosures about the conversion before conducting a member vote. The amendments also require the vote to be by secret ballot and conducted by an independent entity. Finally, the amendments require a federally-insured State credit union to provide NCUA with conversion related information about the law of the State where the credit union is chartered.

DATES: This final rule is effective January 28, 2005.

FOR FURTHER INFORMATION CONTACT: Frank S. Kressman, Staff Attorney, at (703) 518–6540.

SUPPLEMENTARY INFORMATION:

A. Background

The Credit Union Membership Access Act (CUMAA) was enacted into law on August 7, 1998. Public Law 105–21. Section 202 of CUMAA amended the provisions of the Federal Credit Union Act concerning conversion of insured credit unions to MSBs. 12 U.S.C. 1785(b). CUMAA required NCUA to promulgate final rules regarding charter conversions that were: (1) Consistent with CUMAA; (2) consistent with the charter conversion rules promulgated by other financial regulators; and (3) no more or less restrictive than rules applicable to charter conversions of other financial institutions. NCUA issued rules in compliance with this mandate. 63 FR 65532 (November 27, 1998); 64 FR 28733 (May 27, 1999).

Since the enactment of CUMAA, NCUA has become concerned that many credit union members do not appreciate the effect a conversion may have on their ownership interests in the credit union and voting power in the MSB. In February 2004, NCUA amended part 708a to require a converting credit union to disclose additional information to its members to better educate them regarding the conversion. 69 FR 8548 (February 25, 2004). NCUA solicited public comment as part of that rulemaking. Some commenters suggested that, among other things, NCUA should have imposed more disclosures and requirements on converting credit unions. Many offered specific suggestions. NCUA noted at that time that many of those suggestions deserved further consideration but were beyond the scope of that rulemaking and would have to be considered in a future rulemaking. In July 2004, NCUA issued a proposed rule with request for comments to address some of those suggestions and other ongoing concerns NCUA has in connection with protecting members' interests in the conversion process. 69 FR 46111 (August 2, 2004).

B. Discussion

CUMAA provides that an insured credit union may convert to an MSB without the prior approval of NCUA, but it also requires NCUA to administer the member vote on conversion and review the methods and procedures by which the vote is taken. This is reflected in NCUA's conversion rule. The rule requires a converting credit union to provide its members with written notice of its intent to convert. 12 CFR 708a.4. It also specifies that the member notice must adequately describe the purpose and subject matter of the vote on conversion. *Id.* In addition, a converting credit union must notify NCUA of its intent to convert. 12 CFR 708a.5. The credit union must provide NCUA a copy of its member notice, ballot, and all other written materials it has provided or intends to provide to its members in connection with the conversion. *Id.*

A converting credit union has the option of submitting these materials to NCUA before it distributes them to its members. *Id.* This enables the credit union to obtain NCUA's preliminary determination on the methods and procedures of the member vote based on NCUA's review of the written materials. NCUA believes its review of these materials is a practical and unintrusive way of fulfilling, at least part of, its congressionally mandated responsibility to review the methods and procedures of the vote.

If NCUA disapproves of the methods and procedures of the member vote after the vote is conducted, then NCUA is authorized to direct a new vote be taken. 12 CFR 708a.7. NCUA interprets its responsibility to review the methods and procedures of the member vote to include determining that the member notice and other materials sent to the members are accurate and not misleading, all required notices are timely, and the membership vote is conducted in a fair and legal manner.

A charter conversion has consequences that may not surface for a number of years and are often not apparent at the time of conversion to even the most astute members. As a result, members cannot make an informed decision about how the conversion will affect them unless their credit union provides them with this information.

NCUA is aware that credit unions are not providing some important conversion related information effectively to their members. This limits members' ability to make informed decisions about a conversion. NCUA also has become aware that many credit unions may not be equipped to conduct a proper member vote on conversion. Accordingly, NCUA is amending the conversion rule to require a converting credit union to provide additional disclosures to its members. Also, NCUA is providing guidelines to help converting credit unions better understand how they can satisfy the regulatory standard that the member vote be conducted in a fair and legal manner. In addition to the guidelines, NCUA is amending the rule to require the vote be conducted using secret ballots and an independent teller to ensure the integrity of the voting process and the privacy of each member's vote. Finally, NCUA is amending the conversion rule to require a federally-insured State credit union to provide NCUA with information about how the law of the State under which it is chartered relates to NCUA's conversion rule so that NCUA's review of the methods and procedures of the vote includes ensuring compliance with applicable State law.

C. Disclosures

A converting credit union can provide information to its members regarding any aspect of the conversion in any format it wishes, provided all communications are accurate and not misleading. NCUA only requires certain, minimal information be provided in the notice to members. Most converting credit unions choose to provide a great deal more information and, while NCUA recognizes this is a way to educate members, NCUA is concerned that members may be overwhelmed by the great volume of information. NCUA does not, however, wish to dissuade converting credit unions from communicating with their members or limit those communications.

To balance these competing interests, NCUA will continue to allow a converting credit union to communicate with its members as it sees fit, but will require that members receive a short, simple disclosure prepared by NCUA. This disclosure addresses: (1)

Ownership and control of the credit union; (2) operating expenses and their effect on rates and services; (3) the effect of a subsequent conversion to a stock institution; and (4) the costs of conversion. NCUA believes members need to be particularly aware of these topics. NCUA recognizes these topics might be discussed elsewhere in a credit union's communications with its members, but NCUA is concerned that this information may get buried in the great volume of information being provided. Accordingly, a converting credit union must include this disclosure in a prominent place with each written communication it sends to its members regarding the conversion and must take specific steps to ensure that the disclosure is conspicuous to the member. To promote flexibility, a converting credit union may modify the disclosure with the prior consent of the Regional Director and, in the case of a State credit union, the appropriate State supervisory authority (SSA).

Officials of many converting credit unions indicate in their conversion materials that they are unable to raise capital quickly enough to operate their credit unions as they see fit, which often includes a desire to pursue rapid growth. These credit unions encourage their members to support the conversion to an MSB as a way to overcome this capital restraint. They do not, however, inform their members that the conversion process can be expensive and further deplete a credit union's capital. NCUA believes members deserve to know how much of their money will be spent on the conversion effort. Accordingly, NCUA is amending the conversion rule to require converting credit unions to disclose the costs of conversion as part of the above disclosure requirements. An accurate cost estimate must take into account conversion related expenses including printing fees, postage fees, advertising, consulting and professional fees, legal fees, staff time, the cost of holding a special meeting, conducting the vote, and other related expenses.

D. Guidelines for Conducting a Member Vote

A converting credit union must conduct its member vote on conversion in a fair and legal manner. A vote that does not satisfy this standard denies members their democratic right to decide the fate of their credit union and could result in a charter change without the true support of the members. The final rule includes guidelines to avoid these kinds of undesirable results. The guidelines address topics such as: (1) Understanding the relationship between Federal and State law; (2) determining voter eligibility; (3) holding a special meeting.

NCUA does not purport these guidelines are an exhaustive checklist that guarantees a fair and legal vote. Rather, the guidelines are suggestions that provide a framework that, if followed, will help a credit union fulfill its regulatory obligations. A converting credit union should use these guidelines in conjunction with its own independent analysis and planning to tailor the member vote to its particular circumstances.

E. Relationship Between State and Federal Law

Although NCUA's conversion rule applies to all conversions of federally-insured credit unions, federally-insured state credit unions may also be subject to State law on conversions. As stated in previous rulemakings, NCUA's position is that a State legislature or SSA may impose conversion requirements more stringent or restrictive than NCUA's. This position is included in the final rule. In fact, NCUA understands over half the States do not specifically permit conversions of credit unions to MSBs. Reflecting NCUA's support of the dual chartering system, NCUA will defer to a State regulator when appropriate on questions involving interpretation of State law.

When State law applies to a conversion, it can change the procedural and substantive requirements a converting credit union must satisfy. NCUA needs to understand how State law affects those requirements to fulfill its responsibility to review the methods and procedures of the member vote. Accordingly, NCUA requires a federally-insured state credit union to notify NCUA if the State law under which it is chartered permits it to convert to an MSB. The credit union also must inform NCUA if it relies for its authority to convert on a State law parity provision, a provision permitting a state credit union to operate with the same or similar authority as a federal credit union (FCU), and if its State regulatory authority agrees that it may rely on the parity provision for that purpose. Finally, if a federally-insured state credit union relies on a state parity provision for authority to convert, it is required to indicate its State regulatory authority's position as to whether Federal law or State law will control internal governance issues in the conversion such as the requisite membership vote for conversion and the determination of a member's eligibility to vote.

F. Secret Ballots and Third Party Tellers

NCUA understands that members, including those that are employees of the credit union, may be uncomfortable with a voting process that does not protect the privacy of their votes. NCUA is concerned this may lead some members to choose not to vote or to vote in a manner inconsistent with their true wishes. Accordingly, the final rule protects members' privacy by requiring a converting credit union to use a secret ballot and an independent entity to conduct the vote. NCUA requires that a converting credit union use a third party teller to conduct the vote meaning that a third party teller will be responsible for sending ballots, receiving and safe keeping ballots, verifying ballots, and tabulating the vote. Use of a third party teller enhances the integrity of the voting process and provides confidence that members, including employees, will have their votes remain confidential.

G. Written Materials

Since CUMAA, the conversion rule has required a converting credit union to provide NCUA with copies of all written materials it sends or intends to send to its members in connection with the conversion proposal. NCUA is not changing that requirement but is clarifying that it applies to all written materials, including electronic communications posted on Web sites.

H. Summary of Comments

NCUA received 42 comments regarding the proposed rule. Thirty commenters supported the proposal. One so strongly that it stated it was ''criminal'' for credit unions to convert and strip out of the credit union the reserves accumulated over time by many members and put them ''into the pockets of a very few individuals.'' All of the nine commenters who are members of a credit union whose recent conversion campaign failed supported the proposal and many of them indicated that, if the terms of the proposal were in place when their credit union was considering converting, they would have been better informed or the process would have been fairer to members.

Many of the proposal's supporters offered suggestions to improve the rule. For example, ten commenters offered various suggestions to revise the proposed disclosures. Six commenters suggested there should be more required disclosures beyond those proposed.

One of those commenters suggested that paid consultants and service

providers be identified to the members and be required to disclose if they have opened an account at the credit union as a result of their involvement in the conversion. One of the conversion consultants stated that, if the costs of the conversion are to be disclosed, then the credit union should identify the name of the recipients of expenditures. NCUA believes the portion of the proposal that requires a converting credit union to disclose an itemized estimate of the costs of the conversion to its members helps to provide members with necessary information to understand and cast an informed vote on the conversion. NCUA also believes the suggestion that NCUA require a converting credit union to identify by name the recipients of expenditures as part of a detailed itemization of costs is worthy of further consideration. That requirement, however, as well as disclosure of the accountholder status of paid consultants and service providers, are beyond the scope of the proposal and are not adopted in this final rule.

One commenter suggested NCUA provide more voting guidelines than proposed. Another asked NCUA to clarify ''the extent to which the guidelines would be enforced.'' NCUA reiterates the voting guidelines are not regulatory requirements subject to enforcement. Rather, they are suggestions intended to help converting credit unions fulfill their regulatory obligation of conducting its member vote in a fair and legal manner.

Nine commenters stated that the proposed disclosure, which states ''Credit union directors and committee members serve on a volunteer basis,'' is not completely accurate because a number of States allow credit unions to compensate their board members while others are silent on the issue. NCUA is amending the disclosure to reflect these comments.

Seven commenters stated a converting credit union should not be legally required to use Robert's Rules of Order to conduct its special meeting on conversion or suggested there be flexibility to use other parliamentary procedures. One of these commenters also suggested NCUA require a converting credit union to hire an independent parliamentarian to run the meeting. Another commenter did not mention Robert's Rules of Order, but recommended the use of a certified parliamentarian. NCUA discusses the use of Robert's Rules of Order in the voting guidelines section of the proposal. As noted above, the guidelines are not regulatory requirements, and, therefore, a converting credit union is not legally required to follow them including using Robert's Rules of Order in conducting its special meeting relating to the member vote. NCUA recommends, however, that a converting credit union use appropriate parliamentary procedures to conduct its vote, and should enlist the services of an individual knowledgeable and skilled in those procedures. NCUA is revising the voting guidelines to clarify that Robert's Rules of Order are not the only parliamentary procedures a credit union should consider using for its member vote.

Twelve commenters, including the conversion consultants, banking trade organizations, and a bank that was formerly an FCU that had converted to an MSB and subsequently converted to a stock bank, opposed the proposal in general, stating it is inconsistent with CUMAA or obstructs credit unions' right to convert. NCUA fully supports a credit union's right to convert its charter but notes this right belongs to the members of the credit union. Members can only exercise that right in a meaningful way if their credit union provides them with information that is accurate and not misleading. NCUA is aware of the limitations CUMAA places on its authority to approve a conversion but is mindful of its responsibility to oversee the methods and procedures applicable to the member vote on conversion and protect the interests of credit union members.

Some of the commenters who opposed the proposal:

<bullet≤ Believe the disclosure regarding voting rights is inaccurate because an MSB could choose a ''one vote per member'' policy instead of allotting votes based on account balances,

<bullet≤ Highlighted that an MSB to stock conversion requires a number of steps scrutinized by other regulators and stated the disclosure regarding subsequent conversion to a stock institution is misleading and intended to discourage credit union members from voting for the conversion to an MSB,

<bullet≤ Believe NCUA acknowledges the proposal is intended to discourage conversions because NCUA reduced the estimated number of conversions per year in a Paperwork Reduction Act (PRA) filing associated with the proposed rulemaking, and

<bullet≤ Suggested the proposed requirement on state credit unions to provide NCUA with information about State laws affecting the conversion is burdensome or indicated NCUA does not have confidence in SSAs to perform their functions.

The fact that MSBs could choose a ''one vote per member'' policy instead of allotting votes based on account balances is not what MSBs, in fact, usually choose to do. The disclosure regarding voting rights states that, in an MSB, account holders with larger balances ''usually'' have more votes and, thus, greater control. NCUA believes this is an accurate statement. Also, NCUA recognizes that additional steps and member votes are required to approve an MSB to stock institution conversion. This does not lessen NCUA's concern about protecting credit union members' interest in their credit union. Those additional steps and member votes, although possibly scrutinized by other regulators, occur only after the credit union has converted to an MSB and is on its way to converting to the stock form of ownership. Obviously, at that point, the credit union does not exist and the additional requirements can do nothing to enable a credit union member to make an informed decision on the initial conversion from a credit union to an MSB.

The disclosure regarding subsequent conversion to a stock institution is not misleading and not intended to discourage credit union members from voting for the conversion to an MSB. It states that, in a typical conversion to the stock form of ownership, the executives of the institution profit by obtaining stock far in excess of that available to the institution's members. This accurately reflects an executive's ability to obtain stock options, restricted stock or other forms of stock related compensation not available to members not employed by the credit union.

In the normal course of the rulemaking process, NCUA submitted a required PRA filing. In that filing, NCUA reduced the estimated number of conversions per year from a previous submission based on its experience with conversions over the past several years. NCUA would have made the same reduction in the PRA filing based on historical data even if this rule were not being considered.

The requirement on state credit unions to provide NCUA with information about State laws affecting the conversion is not burdensome and does not indicate any lack of confidence in SSAs to perform their functions. NCUA fully acknowledges that a State legislature or SSA may impose conversion requirements more stringent or restrictive than NCUA's. As noted above, when State law applies to a conversion, it can change drastically the procedural and substantive requirements a converting credit union

must satisfy. It is essential for a converting credit union to understand both Federal and State requirements for compliance purposes and for NCUA to do the same to fulfill its responsibility to review the methods and procedures of the member vote as affected by State law. NCUA does not believe it is burdensome for a converting credit union to inform NCUA of State law that the credit union must obtain in any event to assure compliance with all applicable laws. NCUA works closely and cooperatively with SSAs in processing conversions and defers to SSAs in making determinations regarding State law. NCUA believes the subject requirement helps to promote cooperation among the regulators and a more informed converting credit union.

Three commenters disagreed with NCUA's statement that no conversion vote can be fair and legal if some members are improperly excluded. These commenters stated there is no statutory requirement for perfection and that a certain percentage of member exclusions should be tolerated if not the result of wrongful intent on the part of the converting credit union. Since CUMAA, NCUA has disapproved a converting credit union's methods and procedures applicable to the member vote on only one occasion. In that situation, voter disenfranchisement was widespread. NCUA will continue to take a pragmatic approach in reviewing member votes on conversion.

One commenter suggested a converting credit union should be required to prepare a comprehensive three-year business plan for the converted institution similar to the plan required by 12 CFR part 563b for MSBs proposing to convert to stock form. This commenter also stated the plan should be required to be sent to the credit union's members with the notice of intent to convert or the notice should explain how a member can obtain a free copy of the plan. This suggestion is beyond the scope of the proposal, but NCUA will consider it for future inclusion in the conversion rule.

Finally, commenters to previous amendments to the conversion rule have recommended NCUA require converting credit unions to provide members a meaningful way to share their opinions on the conversion and to disclose the views and concerns of the credit union's directors and officers who oppose the conversion. Four commenters to this rulemaking suggested there should be some mechanism in place for members to share their opinions on the conversion with each other and the credit union during the process. NCUA will continue to consider if this is practical and valuable and if it could be accomplished with minimal regulatory burden.

I. Effective Date of Final Rule

Generally, a final rule promulgated by NCUA is effective 30 days following its publication in the **Federal Register**. This final rule, however, is effective immediately upon publication because there is a strong public interest in having this consumer protection rule in place. First, this is necessary to ensure crucial disclosure information is provided to credit union members whose credit union has initiated or is about to initiate the conversion process, so the members may cast an informed and educated vote on the future existence of their credit union and their stake in it. Second, this will provide regulatory certainty to credit unions that are considering converting or beginning the conversion process within the next thirty days and enable them to better understand the regulatory requirements they must follow throughout the entirety of the process.

A converting credit union is required by statute and regulation to provide notice of its intent to convert to its members 90 days, 60 days, and 30 days before the member vote on conversion. 12 U.S.C. 205(b)(2)(C); 12 CFR 708a.4(b). It would be confusing for a converting credit union and its members if this rule became effective during that 90-day period as that would alter the regulatory requirements of the conversion in mid-process. That confusion about which regulatory requirements must be followed at a given point in the conversion process is eliminated for any recently initiated, soon to be initiated, and future conversions by making this rule immediately effective. Accordingly, for good cause, NCUA finds that, pursuant to 5 U.S.C. 553(d)(3), it would be impracticable and contrary to the public interest to delay the effective date of this rule for 30 days following publication. Therefore, this rule is effective immediately upon publication.

Regulatory Procedures

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small credit unions, defined as those under ten million dollars in assets. This final rule amends the procedures an insured credit union must follow to convert to an MSB. Slightly over twenty credit unions have converted since 1995. NCUA anticipates no more than five credit unions per year will convert in the future and it is unlikely that any will have less than ten million dollars in assets. Accordingly, the amendments would not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

Part 708a contains information collection requirements. As required by the PRA, 44 U.S.C. 3507(d), NCUA previously submitted a copy of this regulation in proposed form as part of an information collection package to the Office of Management and Budget (OMB) for its review and approval of a revision to Collection of Information, Conversion of Insured Credit Unions to Mutual Savings Banks, Control Number 3133–0153.

NCUA estimated the average annual burden per converting credit union to be between 20 and 23 hours and that no more than five credit unions will convert per year. As a result, NCUA estimated the total annual collection burden to be no more than 115 hours. NCUA did not receive any comments addressing the accuracy or methodology for computing the burden. OMB approved the revision.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on State and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The final rule would not have substantial direct effects on the States, on the connection between the National Government and the States, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this final rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this rule is not a major rule for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

List of Subjects in 12 CFR Part 708a

Charter conversions, Credit unions.

By the National Credit Union Administration Board on January 13, 2005.

Mary F. Rupp,

Secretary of the Board.